



Pacific National Pty Limited

Public Version

**Application under Part IIIA of the
Trade Practices Act 1974
for a Declaration Recommendation for the Services
provided by Queensland Rail's
Queensland Coal Rail Network**

18 May 2010

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1. Executive Summary

1.1 Pacific National Pty Ltd (ACN 098 060 550) (**Pacific National**) is a wholly owned subsidiary of Asciano Limited. It operates a coal haulage business on standard gauge track in New South Wales and South Australia and on narrow gauge track in Queensland. Pacific National seeks to expand its business in Queensland, having identified the haulage of coal in Queensland as a key growth opportunity due to the predicted growth in Queensland export volumes. In order to grow this business in line with the opportunity which is available, Pacific National needs to be able to secure access arrangements which provide a level playing field on which to compete with the above rail coal haulage business of QR Limited (ACN 124 649 967) known as QR National. The Queensland Government has announced its intention to privatise QR Limited by way of an Initial Public Offering (**IPO**). Whilst the details are still being determined, Pacific National understands that a new company is to be created called QR National Ltd and that entity will hold, amongst other things, QR's above and below rail coal businesses as more specifically described in paragraph 1.3 below. In these circumstances, declaration pursuant to Part IIIA of the *Trade Practices Act 1974* (Cth) (**TPA**) is necessary to achieve the objective of establishing a level playing field for above rail competition in coal haulage.

1.2 Pursuant to s.44F of the TPA, Pacific National seeks a declaration recommendation in respect of four separate but related services which are provided by QR Limited or one of its wholly owned subsidiaries (collectively **QR**). Those services consist of the use of:

- (i) the Blackwater System (as defined in paragraph 3.2) for the purpose of the haulage of coal from mines in the vicinity of the Blackwater System to the port of Gladstone and to coal fired power stations located along that route;
- (ii) the Goonyella System (as defined in paragraph 3.3) for the purpose of the haulage of coal from mines in the vicinity of the Goonyella System to the Dalrymple Bay Coal Terminal and the Hay Point Services Coal Terminal located at Hay Point and to coal fired power stations located along that route;
- (iii) the Moura System (as defined in paragraph 3.4) for the purpose of the haulage of coal from mines in the vicinity of the Moura System to the port of Gladstone and to coal fired power stations located along that route; and
- (iv) the Newlands System (as defined in paragraph 3.5) for the purpose of the haulage of coal from mines in the vicinity of the Newlands System to the port at Abbott Point and to coal fired power stations located along that route,

(collectively **the Services**).

1.3 These applications are made in the context of the impending privatisation of the following aspects of QR's current operations – the coal operations including a long term lease of the

Newlands, Moura, Goonyella and Blackwater coal tracks, and regional coal network control, QR's regional freight business (Qld), mineral and grain haulage (WA & Qld) and containerised freight (Melbourne to Cairns, Melbourne to Perth) and QR's rolling-stock workshops in Redbank, Rockhampton and Townsville and in the context of a still live decision-making process regarding the content of QR's access undertaking.

- 1.4 Each of the Services meets the declaration criteria specified in ss. 44G(2) and 44H(4) of the TPA for the reasons detailed in these applications. A summary of the reasons is set out in paragraphs 1.5 to 1.20 below.
- 1.5 **Criterion (a) - Promotion of competition:** This criterion asks the fundamental question, "*Is access necessary to permit effective competition in the dependent market?*" Put another way, it involves an assessment of whether a right or ability to use the service (compared with the position without any right or ability or with a restricted right or ability to use the service) will lead to a material increase in competition in a dependent market or markets. It does not involve a comparison of the terms and conditions on which access may currently be available with those which would be available under the arbitration mechanisms provided for in Part IIIA of the TPA. Whether or not access currently exists is not relevant to the assessment of Criterion (a) but is relevant to Criterion (f). Here, access compared with no access or restricted access, will lead to a significant improvement in the competitive conditions in the market for rail haulage services for coal. It will also lead to an improvement in the competitive conditions in the market for the exploration for and development of coal tenements in central Queensland, and in the market for globally traded coking coal.
- 1.6 The improvements to competition come about from a range of factors including better performance based incentives for the timely delivery of coal to port, better incentives for investment in capital required to ensure there is capacity to meet future demand for haulage services, encouraging investment in the most efficient infrastructure and an overall lower quality adjusted price for haulage services. These benefits will flow through to make tenements and mines more readily tradeable and at the other end of the chain will flow through to the reliability, timeliness of delivery and pricing of Queensland coking coal in the market for globally traded coking coal. Given the significant proportion of the globally traded market represented by Queensland coking coal, there is a material increase in competition by increasing output of this coal from Queensland.
- 1.7 **Criterion (b) - Uneconomical to develop another facility:** Each of the four rail systems has, with their committed projects taken into account, sufficient capacity to meet foreseeable likely demand for the services. In addition, to the extent that reasonably foreseeable demand exceeds the estimates in the 2009 Coal Rail Infrastructure Master Plan (**CRIMP**), it is clear from the CRIMP itself that the cost of expanding the existing railways to meet likely demand is likely to be significantly less than that associated with duplicating the relevant facilities.

- 1.8 **Criterion (c) - National significance:** Based on the size of the facilities, the importance of the facilities to constitutional trade and commerce and the importance of the facilities to the national economy, Criterion (c) is clearly met.
- 1.9 **Criterion (d) - Health and safety:** The *Transport Infrastructure Act 1994* (Qld) and associated regulations establish a scheme for rail safety accreditation which applies to the facilities and the Services. The relevant regulator is the Department of Transport and Main Roads. Pacific National currently complies with the legislative health and safety scheme referred to above and will continue to do so in its access to the Services in the event that they are declared.
- 1.10 **Criterion (e) - Effective access regime:** There is not an effective access regime which applies to the Services. Presently, it is unclear what regulatory mechanisms will apply to the Services once the Queensland Government sells all of its shares following privatisation. Furthermore, the current combination of legislation, regulations and an undertaking fail to provide any adequate mechanism to address the ability and incentive which a vertically integrated profit maximising entity such as a privatised QR would have to engage in non-price discrimination against other above rail operators. There is both the incentive and ability to do this through a range of mechanisms including targeting network investment, the management of access negotiations, capacity allocation, discriminatory train control decisions and varying network rules.
- 1.11 In order to be effective, it would be necessary for the Queensland Rail Access Regime to have:
- (i) effective separation of the competitive (above rail) and non-competitive (below rail) businesses;
 - (ii) an effective prohibition on preferential treatment;
 - (iii) effective maintenance and investment obligations; and
 - (iv) an effective enforcement regime with appropriate penalties/consequences for non-compliance.
- 1.12 In Queensland, Part 5 of the *Queensland Competition Authority Act, 1997 (QCA Act)* deals with access to services and provides mechanisms for certain types of services to be subject to Ministerial declaration¹, declaration by regulation², the negotiation of access to a declared service³, the resolution of access disputes about declared services⁴, access codes⁵ and access undertakings⁶ and related matters.

¹ Division 2 of Part 5

² Division 3 of Part 5

³ Division 4 of Part 5

- 1.13 Pursuant to s.97 of the QCA Act, the service of "the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating a railway for which Queensland Rail, or a successor assign or subsidiary of Queensland Rail, is the railway manager" has been declared. The declaration has effect only while the rail transport infrastructure remains a public facility.
- 1.14 Pursuant to s.136 of the QCA Act, QR has submitted various voluntary access undertakings to the QCA. A question arises under 44(G)(2)(e) as to what should be considered as the regime in order to determine its effectiveness. The legislation and regulations standing alone do not provide a full picture of the regime. Pacific National therefore considers it appropriate in considering whether there is an effective regime for the Council to examine:
- (i) the legislative scheme;
 - (ii) the undertakings lodged by QR pursuant to that scheme; and
 - (iii) the decisions which have been made by the QCA.
- 1.15 On 9 September 2008 QR submitted a voluntary draft access undertaking (**2009 Draft Access Undertaking**) to the QCA for approval.
- 1.16 The 2009 Draft Access Undertaking was considered by the QCA under Division 7 of Part 5, and the QCA published its draft decision not to approve the 2009 Draft Access Undertaking in December 2009. Concerns with the 2009 Draft Access Undertaking, including its failure to provide third party access seekers with meaningful protection against non-price discrimination by a vertically integrated and (soon to be privatised) QR, and the absence of incentives for QR to engage in such discrimination, are discussed in more detail in Section 10.
- 1.17 QR formally withdrew its 2009 Draft Undertaking and lodged a revised 2010 Draft Access Undertaking (**2010 Proposed Access Undertaking**) on 15 April 2010. The 2010 Proposed Access Undertaking does not accept all of the findings of the QCA in its December 2009 decision. It does address some of the vertical integration issues identified by industry stakeholders and the QCA. However, the amendments are limited and are not wide-ranging enough in scope to cover the range of likely issues identified if QR becomes privatised.
- 1.18 These applications for declaration has been prepared principally on the basis of the 2009 Draft Access Undertaking. They do, however, note where the 2010 Proposed Access Undertaking is different to the 2009 Draft Access Undertaking.

⁴ Division 5 of Part 5

⁵ Division 6 of Part 5

⁶ Division 7 of Part 5

1.19 **Criterion (f) - Public Interest:** Whilst it is not necessary for the public interest to be advanced in order to satisfy this criterion, it is, in fact, the case that declaration will promote the public interest by reason of the following matters:

- (i) efficiency improvements in above rail haulage will lead to increased competitiveness of Queensland coking coal in a global market which will increase the benefits to the Queensland and Australian economies from Queensland coal operations; and
- (ii) any costs flowing from the declaration are not of a sufficient nature or magnitude to offset the benefits which flow from the efficiencies and pro-competitive benefits outlined above.

1.20 It is in the context of Criterion (f) that an assessment can be made as to whether declaration should occur given the terms of access which are currently available and will continue to be available under the Queensland Rail Access Regime. More specifically this is the proper context in which to examine any argument that declaration is contrary to the public interest because regulatory intervention is only warranted where fair and reasonable terms of access are not otherwise available. Pacific National's submission is that there is no basis to assert that declaration is contrary to the public interest because of the issues with the Queensland Rail Access Regime identified in connection with Criterion (e) and the ability and incentive a privatised QR will have to discriminate against other non-affiliated above-rail operators.

2. Applicant Details

2.1 Pacific National is the applicant for declaration of the Services, the details of which are set out in section 3 below. Pacific National and other subsidiaries of Asciano Limited operate Pacific National's coal business. The Pacific National coal business operates rail haulage services for the movement of coal in New South Wales, Queensland and South Australia for both domestic use and for export.

2.2 The contact details for Pacific National are:

Level 6
15 Blue Street
North Sydney NSW 2060
Tel: (02) 8484 8000
Fax: (02) 8484 8154

Attn: Dr Tim Kuypers

3. Identification of the Services and the Facilities

3.1 Pacific National is applying for declaration of four separate but related services as described in paragraphs 3.2 to 3.5 below.

3.2 **The Blackwater System Service** - The Blackwater System Service consists of the use of 994 km of bi-directional narrow gauge railway track (approximately 200 km of which is duplicated and approximately 823 km of which is electrified) which runs from the vicinity of mines proximate to the regions of each of Gregory, Kestrel, Ensham, Minerva, Rolleston, Cook and Curragh to the Port of Gladstone and to coal fired power stations located along that route, as depicted in Figure 11 of the CRIMP annexed to these applications and marked '**Annexure 1**' and the associated infrastructure (**Blackwater Facility**), including, but not limited to:

- (i) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
- (ii) bridges;
- (iii) passing loops;
- (iv) train control systems, signaling systems and communications systems;
- (v) sidings and refuges to park rolling stock;
- (vi) roads and other facilities which provide access to the railway line route;
- (vii) short-term maintenance services; and
- (viii) yards.

3.3 **The Goonyella System Service** - The Goonyella System Service consists of the use of 924 km of bi-directional narrow gauge track, all of which is electrified (with duplicated track between Dalrymple Junction and Wotonga), which runs from the vicinity of mines proximate to the regions of Blair Athol, North Goonyella, Gregory and Hail Creek to the Port of Hay Point and to coal fired power stations located along that route, as depicted in Figure 20 of the CRIMP annexed to these applications and marked '**Annexure '2**' and the associated infrastructure (**Goonyella Facility**), including, but not limited to:

- (i) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
- (ii) bridges;
- (iii) passing loops;
- (iv) train control systems, signaling systems and communications systems;
- (v) sidings and refuges to park rolling stock including Moranbah freight siding (the road to access the main line freight centre);
- (vi) roads and other facilities which provide access to the Goonyella System rail track including Jilalan 4 Road, provisioning shed – leased by Siemens and 2 new Jilalan provisioning roads passing signals 49A/B and 50A/B;
- (vii) short-term maintenance services; and
- (viii) yards.

3.4 **The Moura System Service** - The Moura system service consists of the use of 301 km of single line narrow gauge track which runs from the vicinity of mines in the region of each of Goolara, Koorngoo, Callide Coalfields and Taragoola to the Port of Gladstone and to coal fired power stations located along that route, as depicted in Figure 12 of the CRIMP annexed to these applications and marked '**Annexure 3**' and the associated infrastructure (**Moura Facility**), including, but not limited to:

- (i) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
- (ii) bridges;
- (iii) passing loops;
- (iv) train control systems, signaling systems and communications systems;
- (v) sidings and refuges to park rolling stock;
- (vi) roads and other facilities which provide access to the Moura system rail track including Callemondah Road to access commissioning shed / ED / shed;
- (vii) short-term maintenance services; and
- (viii) yards.

3.5 **The Newlands System Service** - The Newlands system service consists of the use of 203 km of single line narrow gauge track which runs from the vicinity of mines in the region of each of the Newlands and McNaughton to the port at Abbott Point and to coal fired power stations located along that route, and the Goonyella to Abbot Point expansion project (**GAP**) (also known as the Northern Missing Link) to be constructed from North Goonyella to Newlands connecting the Goonyella and Newlands Systems, as depicted in Figure 21 of the CRIMP annexed to these applications and marked "**Annexure 4**" and the associated infrastructure (**Newlands Facility**), including, but not limited to:

- (i) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
- (ii) bridges;
- (iii) passing loops;
- (iv) train control systems, signaling systems and communications systems;
- (v) sidings and refuges to park rolling stock;
- (vi) roads and other facilities which provide access to the Newlands system rail track;
- (vii) short-term maintenance services; and
- (viii) yards.

4. The service provider

4.1 The Blackwater Facility, the Moura Facility, the Goonyella Facility and the Newlands Facility are all owned by QR.

4.2 QR is currently a wholly government-owned integrated rail service provider. QR became a public company in 2007 and comprises five separate business groups consisting of:

- QR Network Pty Ltd (**QR Network**) - a stand alone subsidiary of QR which manages QR's network, railway access, network capacity and traffic management. The board of QR Network is made up of the persons from time to time occupying the positions of the Chief Executive Officer of QR, the Chief Financial Officer of QR and the Executive General Manager of QR Network;
- QR National Coal - provides above rail haulage services for coal in Queensland and the Hunter Valley;
- QR Passenger Pty Ltd - a wholly-owned subsidiary of QR which provides train services for metropolitan, long distance and tourist passengers;
- QR Freight - provides train services for bulk and non-bulk freight (including industrial products, rail line haul and container terminal services for the freight forwarding, shipping and sugar industries and agricultural products); and
- QR Services - provides services and resources to maintain, construct and manage QR's rail infrastructure including undertaking maintenance, modifications, major overhaul, component exchange and manufacturing support for the rolling stock requirements of QR's business group.

QR also has corporate support units which support all of its businesses including Human Resources, Safety, Enterprise Risk Services, Finance and Shared Services and Corporate Affairs, Marketing and Strategy.

4.3 The registered office of QR is:

Level 21
Pipenetworks House
127 Creek Street
Brisbane QLD 4000

4.4 The Queensland Government has announced that it proposes to separate QR's commercial activities from the Government's core public passenger service responsibilities and put those activities into a new company, QR National Limited. That new company will then be publicly listed via an IPO.

4.5 The following areas of operation have been identified as the operations which are to "be sold" and therefore presumably included within QR National Limited:

- QR's coal haulage business - Queensland and NSW operations;
- QR's freight business - regional freight (Queensland); mineral and grain haulage (Western Australia and Queensland); containerized freight (Melbourne to Cairns, Melbourne to Perth);
- coal rail tracks (will be offered in the IPO as a long term lease) comprising each of the Newlands System, the Moura System, the Goonyella System and the Blackwater System;
- QR's rolling stock workshops based in Redbank, Rockhampton and Townsville; and
- regional coal network control.

4.6 The Queensland Government has announced that it will initially retain 25-40 % of the new QR National Limited but will sell down its percentage shareholding after an unspecified period of time.

4.7 It is currently unclear how the asset transfers will be effected or what the status of QR Network will be in the context of the new QR National Limited. Accordingly, the appropriate service provider for the purposes of these declaration applications is QR as the ultimate owner and operator of the Facilities at the date of these applications.

5. Current status of Pacific National's access

A. Reasons for seeking access

5.1 Pacific National has sought to provide coal haulage services in Queensland since at least 2002. Despite significant effort on the part of Pacific National and its predecessor Freight Rail Corporation⁷ and the existence of the Queensland Rail Access Regime, it was unsuccessful in its attempts to do so until customer sponsored entry occurred in 2008.

5.2 In 2008 Pacific National entered into haulage contracts with Rio Tinto Coal Australia and Xstrata Coal for the movement of coal on both the Goonyella and Blackwater Systems. These were the first coal haulage contracts executed by Pacific National for Queensland coal haulage. Since then Pacific National has entered into rail haulage contracts with:

- (i) Anglo Coal for the haulage of existing coal volumes from Anglo Coal's Moranbah mine;

⁷ Examples of previous attempts to win haulage contracts in Queensland include the Rolleston project (consisting of the construction and operation of a spur line and provision of haulage services for 6 mtpa from the new Rolleston mine onto the Blackwater railway system for transport to the port for export (2002)), the provision of haulage services for 40 mtpa (30 mtpa in Queensland and 10 mtpa in NSW) for BMA (an alliance between BHP/Mitsubishi) in 2003, and a haulage contract for Stanwell, Jellinbah and Ensham to transport 6 mtpa.

- (ii) Macarthur Coal to provide haulage services from Moorvale to Dalrymple Bay Coal Terminal (**DBCT**); and
- (iii) Bowen Central Coal to provide haulage services from Isaac Plains to DBCT.

5.3 **[Commercial in Confidence]**

5.4 This growth plan is predicated on the structural and operational arrangements applicable to QR being sufficient to address concerns arising from vertical integration and to ensure that the access terms and conditions available to third party rail haulage operators enable them to be substantive competitors and do not confine them to being fringe players. Pacific National does not believe this is achievable with the current access arrangements and a privatised vertically integrated rail operator.

5.5 Until now Pacific National's access arrangements for the haulage of coal in Queensland have been sought and negotiated in the context of specific customer requests whether pursuant to a formal request for tender or otherwise. The access agreements therefore provide for specific point to point access in the context of the relevant customer. As Pacific National seeks to grow its business in Queensland, it needs to have certainty that it will be able to achieve fair and reasonable terms of access in order to enable it to compete effectively in the provision of haulage services. Declaration of the Services will enable Pacific National to pursue these opportunities.

B. Attempts to negotiate access

5.6 As required by regulation 6A(e) of the *Trade Practices Regulations 1974 (Cth)* this section sets out the efforts which Pacific National has made to negotiate access to the Services. However, unlike the position with most applications for a declaration recommendation under s.44F of the TPA, the manner in which access applications have been dealt with to date under the Queensland Rail Access Regime does not provide any reliable guide as to the basis on which access applications will be dealt with in the future given the impending privatisation of QR's coal business and other aspects of its rail operations (as described in paragraph 4.5 above).

5.7 **[Commercial in confidence]**

5.8 **[Commercial in Confidence]**

6. Criterion (a) - Promotion of competition

A. Legal Requirements

6.1 Section 44G(2)(a) of the TPA (**Criterion (a)**) provides that the National Competition Council (**Council**) cannot recommend that a service be declared unless it is satisfied that access (or increased access) to the service would promote a material increase in competition in at least

one market other than the market for the service. In order to determine that Criterion (a) is satisfied, there must be one or more dependent markets identified which are separate from the market for the service to which access is sought, and access must lead to a materially more competitive environment than would exist in the absence of access.

Meaning of 'Access'

6.2 In *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146 at [83] (**Sydney Airport**), the Full Federal Court determined that the term 'access' in sections 44H(4)(a) and 44G(2)(a) of the TPA should be interpreted by reference to its ordinary English meaning. In this regard the Full Court said:

*[T]he essential notion to be derived from the Hilmer Report, the outline of legislation issued by COAG, the Explanatory Memorandum and the Competition Principles Agreement is that it is necessary for the **fact** of access (in its ordinary meaning) to be relevant to effective competition in another market (upstream or downstream).⁸*
(emphasis added)

6.3 The Council is bound by the decision of the Full Federal Court.

6.4 That decision established that there is no need to identify and determine the existence and extent of a denial or restriction of access for the purposes of Criterion (a).⁹ It recognised declaration as "a public instrument for the more efficient working of essential facilities in the economy".¹⁰ Access was discussed in the COAG explanatory material as the ability of buyers to purchase the use of essential facilities on fair and reasonable terms.¹¹

6.5 The relevant comparison is with the right or ability to use the service compared with the position without any right or ability or with a restricted right or ability to use the service.¹² The terms of s.44 H(4)(a) do not incorporate the requirement for a comparison with what is factually the current position in any given circumstance. Once a declaration is made any potential user can take advantage of it. Thus, it is an unnecessary constriction of a provision, by way of a pre-condition, to engage in a detailed factual enquiry heavily dominated by the past and the present.¹³

6.6 The terms and conditions on which access is and will be available are not relevant to the assessment of Criterion (a). They can, however, be relevant to the decision whether or not a

⁸ *Sydney Airport* [37]

⁹ *Sydney Airport* [76] - [79]

¹⁰ *Sydney Airport* [78]

¹¹ *Sydney Airport* [14]

¹² *Sydney Airport* [83]

¹³ *Sydney Airport* [84]

declaration should be made by reference to Criterion (f) or the discretion which exists even where the criteria are satisfied.¹⁴

6.7 Criterion (a) asks the fundamental question posed by the Hilmer Committee in its report as:

"Is access necessary to permit effective competition in the dependent market?"

Formulating the question in this way is consistent with declaration not being an access seeker specific consideration.

6.8 As a consequence, the fact that an applicant for declaration already has access does not change the enquiry from one about the effect of access to one about the effect of increased access. As the Full Court said:

"Nor does the use of the phrase "increased access" lead to the conclusion that the base for the analysis is the current state of affairs. There was no separate treatment of the phrase in the background material. Access was discussed in the COAG explanatory material as the ability of buyers to purchase the use of essential facilities on fair and reasonable terms. Increased access can be seen as nothing more than an increased or enhanced ability to do so."¹⁵

6.9 Irrespective of whether someone in fact has access, Criterion (a) asks whether someone getting unrestricted access will make a material difference to the competitive conditions in the relevant dependent market. In these applications, that question is readily answered in the affirmative, however, that will not always be the case. It may be that market conditions are such that access makes no difference to competition in that market.

6.10 For example, the dependent market may already be effectively competition and access will make no material difference to the market conditions. This was the Council's finding in relation to the global iron ore market in the various applications for rail access to Pilbara rail infrastructure.¹⁶ Conversely, the market conditions in the dependent market may be characterised by such high barriers to entry that access will not have any material impact on the competitive conditions.

6.11 The proper evidentiary enquiry for Criterion (a) is therefore what are the dependent market conditions and will access make any difference to them?

6.12 Criterion (f) and the discretion then permit an examination of whether declaration should occur given the terms of access which are currently available and will continue to be

¹⁴ *Sydney Airport* [85]

¹⁵ *Sydney Airport* [87]

¹⁶ For example, see National Competition Council Final Recommendation in relation to the Application for declaration of a service provided by the Mt Newman Railway Line under section 44F(1) of the Trade Practices Act 1974 (Cth) dated 23 March 2006 at [7.159] (**Mt Newman Final Recommendation**).

available. That would permit a refusal to declare if the forward looking terms and conditions of access are fair and reasonable.

- 6.13 A service provider could assert that declaration would be contrary to the public interest because the terms and conditions on which access is available are fair and reasonable and regulatory intervention is only warranted when that is not the case. In the present case that involves an assessment of whether fair and reasonable terms and conditions will be available from a privatised QR. Pacific National's submission is that there is no basis to assert it is contrary to the public interest for declarations to be made because of the issues with the Queensland rail regime identified in connection with Criterion (e) and the ability and incentive a privatised QR will have to discriminate against other non-affiliated haulage providers. These issues are discussed in the context of Criterion (f).

Test for identifying the dependent markets

- 6.14 Criterion (a) requires the identification of a dependent market separate to the market in which the service is provided. The detail of the approach which the Council uses to identify markets for the purposes of Criterion (a) is clearly set out in paragraphs 3.5 - 3.27 of the National Competition Council 'A Guide to Declaration under Part IIIA of the Trade Practices Act 1974 (Cth)' dated August 2009 (**Declaration Guide**). Those principles are an appropriate basis on which to determine whether or not relevant separate markets exist in the present applications and are used by Pacific National in delineating the markets in which competition will be promoted as a result of access.
- 6.15 Markets have three key dimensions - product, geography and function. The identified separate market or markets may be different in terms of any or all of those dimensions.
- 6.16 The approach which Pacific National uses in these applications to identify the relevant separate markets and ask whether they are separate from the markets for the Services is:
- (i) to examine whether markets are functionally distinct by assessing whether the complementarities of vertical integration are such as to dictate vertical integration;
 - (ii) to determine the geographic dimension of the market by an assessment of the area within which substitution in demand and supply occurs and the extent of such substitution; and
 - (iii) to consider when customers would substitute one product for the other following a small but significant change in the relative prices and when a producer can readily switch from producing one product to producing another.

Material increase in competition

- 6.17 Whether access will promote a material increase in competition in a dependent market depends upon an assessment of the structure of the relevant dependent market and the

competitive dynamics in it. What is required is a consideration of industry and market structure followed by a judgment of their effects on the promotion of competition.¹⁷

B. Application of the Law to the Facts

Relevant Downstream Markets

6.18 In each of these applications, there are three markets separate from the market in which the Services are provided which should be examined by the Council in its consideration of Criterion (a). They are:

- the market for the provision of haulage services for coal on narrow gauge rail lines in Queensland (**rail haulage market**);
- the market for the development and exploitation of coal mines and tenements in central Queensland in proximity to the Systems; and
- the market for globally traded coking coal.

6.19 As the Council has previously noted,¹⁸ it will generally not be necessary to consider all possible dependent markets in considering a declaration application. Consistent with the Council's practice identified in its Declaration Guide, Pacific National has identified the three most likely dependent markets in which there will be a promotion of competition. That does not involve a statement by Pacific National that these are the only markets in which competition would be promoted. Rather, it is sufficient for the purposes of these applications to demonstrate that the promotion of competition occurs in one of those dependent markets.

(a) Rail Haulage Market

6.20 In the context of Part IIIA of the TPA it is often a functionally separate market which is being considered.¹⁹ That is the case here in considering whether rail haulage markets are separate markets from the markets for the provision of track access. In order to determine whether there is a separate market, the question is whether there are such overwhelming efficiencies from vertical integration, and the provision of the vertically related activity, that they must necessarily occur in the same functional market.²⁰

6.21 There are no such overwhelming efficiencies between track access and rail haulage. Characteristics of entry in track access and rail haulage are quite different. The costs of entering the market for track access are very significant and are coupled with the risk that entry would not be viable given the natural monopoly characteristics of the rail track

¹⁷ *Duke EGP* at [116]; see also paras 6.9 to 6.11 above.

¹⁸ See Declaration Guide at [3.19].

¹⁹ See [3.16] of the Declaration Guide.

²⁰ *Services Sydney* at [116-118].

services.²¹ The costs of entering the rail haulage market, whilst substantial, are of a significantly lower order of magnitude than those required to provide track access services.

- 6.22 The rail assets required to provide the rail track services, namely railway tracks, sidings, switches, signals and track maintenance services are distinct from those required to provide coal rail haulage services, namely locomotives, rolling stock and maintenance services for such equipment.
- 6.23 In Australia there was a history of integrated track and haulage supply on an intra-state basis,²² however, this was more a function of government policy than the underlying economics of rail track and rail haulage operations and that position has now changed.
- 6.24 Since the national competition policy reforms of the 1990's there has been significant separate provision of track access and rail haulage services. Australian Rail Track Corporation (**ARTC**) has responsibility for management of the National Interstate Rail Network (**Interstate Network**) which includes track, some of which is owned by ARTC and some of which is leased by ARTC. A number of rail operators run trains on the Interstate Network including Pacific National, Specialized Container Transport and QR. In addition, ARTC has a long term lease over the Hunter Valley coal rail network on which Pacific National and QR operate trains. The Victorian rail network is owned by the State Government (having been sold back to the Victorian Government by Pacific National) with Pacific National providing rail haulage services on that network.
- 6.25 Consistent with this factual position of significant separate provision of track access and rail haulage services, both the Council and the Australian Competition Tribunal (**Tribunal**) have consistently found the existence of track access markets separate and distinct from the markets in which rail haulage services are provided and from the markets in which the commodities being transported are sold.²³ The markets in which the Services are provided are markets in which heavy haul railway track and associated infrastructure services are provided and acquired along the routes represented by each respective identified rail system. As can be seen from the evidence of separate provision detailed in paragraph 6.24 above, there is no basis on which to conclude that the degree of integration between the operation of rail infrastructure and the operation of trains on such infrastructure is such that the two must invariably be undertaken by one entity.

(b) **Market for coal mines and tenements in central Queensland**

²¹ See paras 7.13 to 7.9 below.

²² When National Rail Corporation Ltd was formed as the interstate rail freight operator, it commenced operations only as a rail haulage operator.

²³ See National Competition Council Final Recommendation in relation to the Application for declaration of a service provided by the Goldsworthy Railway Line under section 44F(1) of the Trade Practices Act 1974 (Cth) dated 29 August 2008 at [4.38-4.40] (**Goldsworthy Final Recommendation**); *Re Sydney International Airport* (2000) 156 FLR 10 at 39; National Competition Council Final Recommendation for declaration of services provided by Westrail dated 21 November 1997 at p 17-18; *Rail Access Corporation v NSW Minerals Council* (1998) 87 FCR 517.

- 6.26 There is a market for the development and exploitation of coal mines and tenements in central Queensland in proximity to the Systems which is functionally separate from the market for the provision of track access.
- 6.27 The activities that take place within the context of the market for coal mines and tenements involve the exploration and prospecting for coal tenements and the development of prospective coal tenements into coal mines. These activities are distinct from both the provision of track access and the provision of rail haulage services for coal once it is extracted. An equivalent position exists in the Hunter Valley in NSW which is the other main coal mining area in Australia.
- 6.28 Exploration and mining activities are undertaken by companies focused on coal mining and it is not usual practice for them to operate the rail track or undertake rail haulage services.. This reflects the fact that there are not significant efficiencies from vertical integration. This is consistent with the previous decisions of the Council.²⁴

(c) **Market for globally traded coking coal**

- 6.29 Coal is generally divided into two broad categories - coking or metallurgical coal and thermal coal. These different types of coal perform different functions. Coking coal is used, together with iron ore to produce pig iron in traditional blast oxygen furnaces. The pig iron is then used to produce crude steel. Thermal coal is used for heating with the vast majority used in power stations generating electricity with lesser amounts used in cement manufacture, small boilers and other specialist uses.
- 6.30 Coking coal and thermal coal have distinct demand profiles with demand for coking coal forecast to grow at an annual growth rate of 4% to 2025 whereas thermal coal will grow at a growth rate of about 2.5% during the same period. Coking coal is significantly more expensive than thermal coal with coking coal currently trading at approximately \$200 per tonne and thermal coal at approximately \$95 per tonne.
- 6.31 The distinction between these coal types has consistently lead the Australian Competition and Consumer Commission to identify functionally distinct markets for the supply of coking coal and thermal coal when considering mergers in the coal sector.²⁵
- 6.32 Whilst the type of coal is not significant for the purposes of the rail haulage market, it is significant in considering whether access has any impact on the relevant end product market for the sale of coal. Given the differences between coking coal and thermal coal it is appropriate to recognise those differences in separate product markets for each type of coal.

²⁴ See National Competition Council Final Recommendation in relation to the Application for declaration of a service provided by the Robe Railway Line under section 44F(1) of the Trade Practices Act 1974 (Cth) dated 29 August 2008 at [4.38] (**Robe Final Recommendation**); National Competition Council Final Recommendation in relation to the Application for declaration of a service provided by the Hamersley Railway Line under section 44F(1) of the Trade Practices Act 1974 (Cth) dated 29 August 2008 at [4.38] (**Hamersley Final Recommendation**).

- 6.33 Queensland's export coal industry is the largest in Australia accounting for approximately 58% of Australian coal exports. Approximately 85% of Queensland's coal production is exported. These Queensland exports comprise 50% of globally traded coking coal and almost 10% of global traded thermal coal. Given the proportion of globally traded coking coal hauled on the Facilities and exported from Queensland, it is competition in that market which Pacific National considers most likely to be affected by access to the Services.
- 6.34 The products involved in the market for globally traded coking coal are clearly distinct from those involved in the provision of rail access. The efficiencies from vertical integration of ownership of rail infrastructure and the sale of globally traded coking coal are not so overwhelming that they dictate that these activities must occur in the same functional market. The activities are economically separable as is evident from such operations within Australia. The two activities also employ assets that are quite specific and quite distinct. That is, the assets used to produce rail track services would not appear to be able to be readily used to trade coking coal on an international basis.
- 6.35 There is no basis for concluding that the markets for the Services, the market for haulage services on the relevant railways, the market for coal mines and tenements and the market for coking coal are merely elements of an overall market for globally traded coking coal. Adopting such a broad approach to market definition would obscure any meaningful competitive analysis in the way described by the Tribunal in *Services Sydney*. In that decision, the Tribunal in addressing the question of economic separability stated:

"One approach to assessing efficiencies of vertical integration is to posit that where the transaction costs of market coordination between vertical stages of supply exceed those for administrative coordination with the firm, there will be no separate market for the service(s). However, a literal interpretation of that test could prevent the very benefits of competition in dependent markets, which Part IIIA is designed to achieve, from being realised. It is not difficult to imagine a situation where the coordination costs within a vertically integrated firm are less than the costs of market transactions for a particular service; but where there exists a more cost efficient potential entrant to an upstream or downstream dependent stage of the supply chain, who can more than offset the additional transaction costs with their superior efficiency. Entry of such a firm would be pro-competitive and economically efficient, yet a narrow view of the test would have the consequence that no market for the service would be defined and hence there would possibly be no declaration and no entry. The community would be denied the very kind of benefits arising from competition that were envisaged by the report of the Independent Committee of Inquiry into Competition Policy in Australia on National Competition Policy (the Hilmer Report) and which underpin the access regime principles in Part IIIA.

*A broader approach, which asks whether the complementarities of vertical integration are such as to dictate vertical integration, would not preclude declaration and competition in these circumstances. This approach was generally adopted in the NCC's Final Report and is consistent with that adopted by the Tribunal in *Re Sydney International Airport*:*

²⁵ For example see Xstrata Coal Pty Limited proposed acquisition of Gloucester Coal April 2007; Xstrata proposed acquisition of Centennial Coal Company Limited October 2007; Xstrata proposed acquisition of Resource Pacific Holdings Limited January 2008.

An alternative, more precise, test could involve looking at some combination of both transaction costs and service delivery costs. If there was a demand for the service at a price which covered these combined costs, then a market could be said to exist.²⁶

Promotion of Competition in the dependent markets

a) Promotion of Competition in the Rail Haulage Market

- 6.36 As discussed in paragraph 6.8 - 6.11 above, the relevant evidentiary inquiry involves an examination of the dependent market conditions and whether access will make any difference to them. In these circumstances it is clear that access and particularly an unrestricted right of access will have a very significant impact on the competitive conditions in the rail haulage market.
- 6.37 The market for haulage services has the following features:
- (i) there are economies of scale in the provision of haulage services;
 - (ii) long term investment commitments are required for a third party to be competitive; and
 - (iii) customers have significant bargaining power.
- 6.38 Without access being granted to the Services, it is only QR which could offer a haulage service for coal. Whilst Pacific National has won some haulage contracts and obtained access arrangements to support those, its entry has been limited with competition currently occurring only at the margin. That limited entry can provide some insight into the way in which competition could be promoted for the purpose of analysing Criterion (a).
- 6.39 The key areas in which Pacific National's entry has improved the competitive dynamics of the rail haulage market are:
- (i) the introduction of key performance indicators with financial implications for the haulage provider if those key performance indicators are not met. Before Pacific National's entry, whilst contracts contained performance indicators there were no financial implications for non-compliance and, with no alternate provider, little credible threat of customers switching to another rail haulage provider;
 - (ii) a move to a greater level of transparency in pricing. For example, some coal haulage contracts will now include explicit benchmark rates of return in the contract; and
 - (iii) improved efficiency in above rail operations, including faster cycle times. One of the key recommendations of the O'Donnell Report was to establish a business

²⁶ *Services Sydney* at [116-118].

improvement project following his identification of improvement opportunities that were worth pursuing in areas such as locomotive reliability, cycle time reductions and unloading and loading performance.

b) Promotion of competition in the market for coal mines and tenements in proximity to the Systems

6.40 As rail transport is, in most instances, the most cost effective way of transporting coal to the ports (except for transport over very short distances), access to haulage services is critical for coal miners to operate profitably and justify developing and exploiting their mines and tenements for maximum returns.

6.41 Without a right of access to rail transportation, many coal producers in central Queensland would have no economically viable way of getting their coal products from the mine to the port for export or to power stations for domestic use. This would result in some coal tenements being effectively stranded and unable to be developed and exploited by coal producers, due to the absence of other viable transport options. This would adversely impact upon competition by lowering tenement trading values, reducing the pool of prospective tenement purchasers and discouraging companies from engaging in future exploration and prospecting activities due to the uncertainty surrounding:

- (i) securing a high tenement trading value (if the company does not intend to develop and exploit the tenement itself); or
- (ii) being able to develop and commercially exploit the mines/tenements

due to an absence of access to rail transport for coal products in central Queensland.

6.42 Access to track services would encourage greater activity in tenement exploration and development around each of the Systems as tenement owners would have the opportunity to commercialise their endeavours and not have to face a situation whereby their coal deposits are stranded and unable to be exploited due to no viable means of transport being available.

6.43 The right of access would also encourage more companies to invest in prospecting and exploring tenements in the vicinity of the Systems due to the likely increase in the pool of potential purchasers of the tenements and increase in value of these tenements that would result if access to rail transport was available to enable the coal mines and tenements to be exploited, instead of serving as a barrier to such exploitation.

6.44 Access to the Services is consequently essential for anyone wishing to compete in the market exploration and development of coal mines and tenements in the proximity of the Systems, as it provides coal producers with a guaranteed right to access rail transport services, a necessary input in the coal supply chain, to deliver their coal to the port for export.

c) Promotion of competition in the market for globally traded coking coal

- 6.45 Australia has the fifth largest reserves of hard coal (coking coal) but it is the leading coal exporter globally. The reasons for this include the proximity of Australian coal mines to deep water ports and the high quality of Australian export coals.²⁷
- 6.46 Australia's coking coal exports in 2006/7 were predominantly to Japan (25%), the European Union (20%), India (16%), South Korea (6%), Taiwan (3%), China (2%) and other countries representing the remaining 9%.²⁸
- 6.47 Rail haulage costs are approximately **[Commercial in Confidence]** It is therefore a significant component of the cost of coal even at current high coal prices and has been an even more significant component when prices are lower.
- 6.48 Access to the Services will facilitate an increase in competition in the rail haulage market which will enable improvement in the quality adjusted price at which haulage services are provided, which would in turn provide benefits in the competitive positioning of Queensland coking coal in the globally traded coking coal market. This would allow Queensland coal producers to take advantage of their locational advantage over other countries and the close proximity of mines to the ports, thereby allowing for reduced transport costs (when viewed as a component of the total cost of developing and exporting coking coal) by comparison to other coal producing countries. These benefits will improve the competitiveness of Queensland coking coal and given its position in the market for globally traded coking coal will materially enhance competitive conditions in that market.

Comparison of terms and conditions of access

- 6.49 If, contrary to the submission put by Pacific National in paragraph 6.2 to 6.13 above, the Council takes the view that Criterion (a) involves a comparative assessment of the terms and conditions on which access is currently either actually or potentially available with those which would apply if declaration were to occur, Criterion (a) is nonetheless satisfied in the present circumstances.
- 6.50 The conditions on which access is currently available are those provided for under the current QR Access Undertaking, which has been in place since 2008 (**QR Access Undertaking**) and those on which access may potentially be available in the future are those contained in the 2010 Proposed Access Undertaking submitted by QR to the QCA on 15 April 2010.. Both the structure of those access arrangements and the current and proposed access undertakings which have resulted from those arrangements demonstrate both:
- (i) the inability of those access arrangements to provide a level playing field on which a rail haulage operator can compete with QR's above-rail business; and

²⁷ The University of Queensland, 'Coal and the Commonwealth - The Greatness of an Australian Resource' (October 2009) at p 77.

²⁸ The Australian Bureau of Agricultural and Resource Economics (2009).

- (ii) that they are not consistent with the nature of the access arrangements which would flow from a proper application of the principles which guide access arbitrations pursuant to Part IIIA of the TPA.

This issue is examined in detail in section 10.

- 6.51 The current legislative arrangements and the 2010 Proposed Access Undertaking which is proposed to be in place pursuant to those arrangements do not provide appropriate ring fencing or effective non-discrimination arrangements between above rail operators. These concerns already exist in the context of QR as a government owned entity; however, they will be attenuated with the privatisation of QR. Privatisation will sharpen QR's commercial incentives to discriminate between above rail competitors.
- 6.52 To date, QR Network has not had purely commercial motives but has acted partially as an instrument of government policy. This is reflected, for example, in a requirement that the Minister approve significant access contracts.
- 6.53 A privatised QR would have a fiduciary duty to maximise its value for shareholders by, amongst other things, exercising its monopoly power to minimise above rail competition and charge non-cost reflective prices for haulage services to extract rents from tenement developers, provided it did so within the law. This would have the effect of reducing tenement trading values (as well as the pool of prospective purchasers) and would provide commercial disincentives for companies to undertake future exploration and prospecting activities due to the uncertainty of securing a profitable sale of their tenement or, in cases where they propose to develop and exploit the tenement themselves, the potential risk of being unable to fully exploit the tenement due to an inability to secure rail transport on fair and reasonable terms. The current access arrangements and those contained in the 2010 Proposed Access Undertaking, such as the proposed anti-discrimination clause²⁹, are not sufficiently robust to deal with this situation.³⁰

7. Criterion (b) - uneconomical to develop another facility

A. Legal requirements

- 7.1 Section 44G(2)(b) of the TPA (**Criterion (b)**) requires that the Council be satisfied that "*it would be uneconomical for anyone to develop another facility to provide the service*". As the Council has said:³¹ "*This criterion seeks to ensure that declaration is limited to situations where the development of additional facilities would increase costs, waste economic resources and generally be contrary to Australia's national interest.*"

²⁹ See clause 2.2 of the 2010 Proposed Access Undertaking.

³⁰ See section 3 of Castalia Strategic Advisor's 'Review of the Queensland Rail Access Regime' report dated May 2009 (**Castalia Report**), which is annexed to these applications and marked '**Annexure 7**'.

³¹ Hamersley Final Recommendation at [5.1].

- 7.2 Both the Council and the Tribunal have consistently interpreted the word "*uneconomical*" in Criterion (b) in a social cost benefit sense rather than in terms of private commercial interests.³² This approach is consistent with the objects of Part IIIA which relevantly are to "*promote the economically efficient operation of, use of, and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets*".³³
- 7.3 In this context the Council has identified Criterion (b) as focusing on whether a facility exhibits natural monopoly characteristics such that a single facility is capable of meeting likely demand at lower cost than two or more facilities.³⁴ The key characteristics of a natural monopoly relate to the presence of significant economies of scale and/or economies of scope, the existence of substantial fixed or capital costs, relatively low variable or operating costs and large and lumpy investment costs.
- 7.4 In proceedings before the Tribunal which are currently pending, certain parties have argued for a different approach to Criterion (b).³⁵ Some parties have argued that a private investment test should be used in applying Criterion (b), whilst another argued that a variant of the social test (described as a net social benefit test) which involves an assessment of the revenues of any access seeker from using the provider's facility less the full cost of access (including co-ordination costs, opportunity costs and additional capital costs) should be applied.³⁶ Pacific National submits that the social cost approach to the interpretation of Criterion (b) which has been consistently applied by the Tribunal and by the Council should be applied in this matter.

B. Application of the law to the facts

- 7.5 As detailed in paras 3.2 to 3.5 the Services to which access is sought are the use of the relevant rail track (and associated infrastructure) from points proximate to mine sites, in the case of Moura and Blackwater systems, to the Port of Gladstone and all power stations located along those routes, and, in the case of the Goonyella and Newlands systems, to the DBCT and Abbott Point Coal Terminals and all power stations located along those routes.

³² *Re Sydney International Airport* [2000] AComp T1 at [204] to [205]; *Duke EGP* at [64] and [137]; *Re Services Sydney Pty Limited* [2005] AComp T7 and *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146; [5.44] of the Robe Final Recommendation; t [6.12, 6.15, 6.51] of the Mt Newman Final Recommendation.

³³ Section 44AA of the TPA.

³⁴ See [5.3. of the] Hamersley Final Recommendation.

³⁵ See [3.2-3.7] of Rio Tinto & Ors 'Final Submissions Regarding Legal and Economic Principles' dated 1 December 2009 filed in Re Application for review of a decision by the Commonwealth Treasurer of 27 October 2008 under section 44H(1) of the Trade Practices Act 1974 (Cth) in relation to the application for declaration of the service provided by the Robe Railway, 'Australian Competition Tribunal Proceeding No 3 of 2008, and No 5 of 2006 and Nos 4-5 of 2008 (collectively referred to as the **Pilbara Tribunal Proceedings**); [230, and 20-56 generally] of the 'Closing Submissions of BHP Billiton Iron Ore Pty Ltd and BHP Billiton Minerals Pty Ltd' dated 1 December 2009 filed in the Pilbara Tribunal Proceedings.

³⁶ See [Section 7] of Fortescue Metal Group Limited's 'Closing Submissions on Law and Economics' dated 1 December 2009 filed in the Pilbara Tribunal Proceedings.

7.6 The Moura and Blackwater systems both meet at Gladstone but are not otherwise interconnected. The Blackwater and Goonyella systems join at Gregory. This enables mines in the Gregory vicinity to look to alternately use Gladstone or Dalrymple Bay ports. The Goonyella and Newlands systems do not currently interconnect but will do so upon construction of the GAP.

7.7 Consistent with the Council's approach in the Hamersley Final Recommendation and related final recommendations,³⁷ Pacific National approaches the assessment of Criterion (b) by:

- (i) considering whether there are any alternative facilities that could provide the Services;
- (ii) considering the economic characteristics of heavy haul railways, including the specific characteristics of the Queensland coal network, to determine whether they exhibit natural monopoly characteristics;
- (iii) considering current and likely forecast demand for the Services;
- (iv) examining whether foreseeable demand can be met within the capacity (current and planned) of the relevant system; and
- (v) where access is likely to result in demand exceeding capacity, comparing the likely costs of expanding the system to meet the excess demand with the cost of constructing an alternative facility to meet the extra demand of access seekers.

a) Alternative facilities that could provide the Services

7.8 For the purposes of these applications, a separate supply and demand analysis is undertaken for each system. This reflects the current inability of any one of the existing systems to provide an alternative service to that provided by the other systems with the exception of a limited number of mines in the Gregory area.

7.9 Once the GAP is constructed, there will be options for a range of mines in the Goonyella and Newlands areas to access either the Newlands system or the Goonyella system and they then have the options of Abbot Point Coal Terminal or Dalrymple Bay and Hay Point Coal Terminals available to them.

7.10 Given the transportation distances involved, there is no alternative mode of transport which is a substitute for movement of coal by rail. The average distance from the mines to the ports in the Goonyella and Blackwater Systems are 208 km and 351 km respectively. It is not viable either in terms of the price which would be charged nor in terms of the congestion which would result given the number of trucks which would be required.

³⁷ For example, see Section 5 of the Hamersley Final Recommendation; section 5 of the Goldsworthy Final Recommendation.

- 7.11 There are no current or planned rail track alternatives which are available to provide the Services.
- 7.12 There are under consideration several proposals which contemplate the construction of a standard gauge rail line by private miners from the Galilee Basin to Abbot Point.³⁸ As Pacific National understands, these proposals would involve a rail link of over 450 km. Neither of these projects is currently committed to and it is unclear whether one or both will proceed. In any event, they would not provide an alternative to any of the Services for which declaration is sought because:

- (i) they do not cover the same route;
- (ii) they are for a standard gauge rail track on which narrow gauge rolling stock is not capable of being utilised unless converted to standard gauge rolling stock, which involves significant time and expense; and
- (iii) they are not proximate to either existing mines or deposits which could utilise the Services.

b) Presence of natural monopoly characteristics

- 7.13 The Council has previously given detailed consideration to the presence of natural monopoly characteristics in the context of heavy haulage rail lines.³⁹ Many of those comments apply equally here. In particular, as in the case in the Hamersley and related applications, the provision of services of the type for which declaration is sought in these applications involves:

- construction of the rail infrastructure, and includes the purchase of land, earthworks, track construction and installation of signalling equipment;
- maintenance and renewal of the rail infrastructure, including repairs and replacement of track, signals and platforms; and
- coordination and management of traffic on the rail infrastructure, including train control and implementation of safe working procedures.

- 7.14 The provision of this infrastructure requires significant capital investment. While ongoing maintenance costs and other operation costs associated with the railway service are likely to be significant, they are relatively small compared to the capital costs incurred in developing the Facilities.

³⁸ - See 'Gina Rinehart's \$2.2 bn rail bid in Queensland', *The Australian*, 2 February 2010, available at <http://www.theaustralian.com.au/business/gina-rineharts-22bn-rail-bid-in-queensland/story-e6frg8zx-1225832367229>; 'Queensland leads economic recovery with \$US5.15 billion project', *Waratah Coal Media Release* dated 27 May 2009, available at http://www.waratahcoal.com/documents/27-05-09_n_000.pdf.

³⁹ See [5.55-5.101] of the Hamersley Final Recommendation; [5.54-5.99] of the Robe Final Recommendation; [5.62-5.112] of the Goldsworthy Final Recommendation.

7.15 In addition, the capacity of a railway can often be expanded significantly at a relatively low incremental cost through discrete additions of capacity in the form of passing loops and upgraded signalling. Once incremental expansion options are exhausted (typically this occurs once passing loops are around ten kilometres apart) the track must be duplicated or multi-tracked. This involves a much more substantial investment but delivers a disproportionately large increase in capacity compared to the construction of a similar length track on a stand alone basis.⁴⁰

7.16 QR has itself analysed in detail the economic costs of freight infrastructure in its 2006 Submission to the Productivity Commission's Review of the Economic Costs of Freight Infrastructure and Efficient Approaches to Transport Pricing. In that submission QR estimated, using a life cycle cost framework, that for a typical freight railway, capital costs account for approximately 60% of total costs and maintenance (such as inspections, ballast and track replacement, and rail grinding) accounts for around 25% of total costs. The remaining 15% are operating costs.⁴¹ Heavy haul bulk rail systems typically involve the greatest construction and maintenance costs per kilometre because of the significant wear and tear impact of the heavy trains on the track. That analysis by QR is, of course, addressed to precisely the infrastructure which is at issue here and can therefore readily be relied upon by the Council. A copy of the QR submission is annexed to this application and marked '**Annexure 5**'.

7.17 The UT3 Opening Asset Value for the four coal Systems was approximately \$2.86 billion broken down between the four Systems as set out below:

(i)	Blackwater System UT3 Opening Asset Value	\$1,177,219,000
(ii)	Goonyella System UT3 Opening Asset Value	\$1,264,674,000
(iii)	Moura System UT3 Opening Asset Value	\$253,460,000
(iv)	Newlands System UT3 Opening Asset Value	\$165,424,000

7.18 As stated by QR Network in the CRIMP, "*the existing network has been developed over a number of decades and now represents a multi-billion dollar investment. The network capability has progressively increased by electrification, track duplication, additional crossing links and concrete re-sleeping, curve realignment and grade easing. This has facilitated the increase of axle loads, train lengths and train speeds to their current levels.*"

7.19 This represents the cost of the facility using efficient technology but reflecting the current standard/quality level of the Facilities. This is therefore a significant under-estimate of the cost which would be incurred in developing alternate rail lines to provide the Services. The Council's usual approach is to use replacement cost without any allowance for depreciation.

⁴⁰ Paras 5.58, 5.59 and 5.62 of the Hamersley final recommendation.

c) Existing Rail Network Capacity

7.20 Under the current QR Access Undertaking, QR is required to prepare the CRIMP.⁴² The CRIMP is to inform stakeholders of the scope, cost and timing of investments required in the coal supply chain to support industry growth.⁴³

7.21 For the purposes of the 2009 CRIMP, QR used a long term Queensland coal export industry analysis undertaken by Wood Mackenzie dated May 2009. Pacific National regards this as a reliable basis upon which to proceed and adopts it for the purposes of assessing likely demand for the Services. Details of the work can be found in section 3 of the CRIMP. A copy of the CRIMP is annexed to these applications and marked '**Annexure 6**'.

7.22 The existing QR rail systems are narrow gauge and are currently capable of handling trains up to 10,000 net tonnes travelling at 80 km/hr. The current maximum train lengths and net train loads are shown below.

Track Gauge (mm)	Axle Load (tonnes)	Ruling Grade	Max. Train Speed (km/hr)	Max. Train Length (metres)	Electric Traction	Max. Net Train Load (tonnes)	System
1067	20	1:80	80	1300	No	5000	QR Newlands System
1067	26.5	1:80	80	1700	No	8350	QR Moura System
1067	26.5	1:86	80	1700	Yes	8350	QR Blackwater system
1067	26.5	1:100	80	2100	Yes	10000	QR Goonyella System

i) Newlands System Capacity

7.23 The Newlands System is not currently electrified and provides about 19 mtpa rail capacity (2008/09 throughput was 14.2 mtpa) with diesel trains up to 1300 metres in length and 20 tonne axle loads.⁴⁴ There are plans to increase the rail capacity to 50 mtpa (at which point it would match the current expansion plans for Abbot Point Coal Terminal) by the GAP. This will enable diesel hold trains of 1402 metres in length with a 26.5 tonne axle load to use the

⁴¹ QR submission to Productivity Commission (5 July 2006) at p 21.

⁴² Under Clause 2.2.1 of Schedule FB of the QR Access Undertaking (dated October 2008), QR Network is required to develop a comprehensive Coal System Master Plan (which relates to its proposed capital expenditure projects and contains the information specified under clause 2.2.1(d) of Schedule FB to the Undertaking. The Coal System Master Plan must be for a minimum of three years and QR Network must actively involve the Coal System Master Planning Forum (which consists of parties such as Customers and access holders for coal carrying Train Services and the QCA) in the development of the Coal System Master Plan. An updated Coal System Master Plan must be provided by QR Network to the Coal System Master Planning Forum by the end of June each year. See Clause 2.2.1 of Schedule FB of the QR Network Access Undertaking for more details.

⁴³ 2009 Coal Rail Infrastructure Master Plan page 4.

⁴⁴ CRIMP at p 27.

system. A more detailed description of the GAP is contained in Section 6.7.1 of the CRIMP.⁴⁵

7.24 QR has identified that capacity may be further increased on the Newlands System from 50 mtpa to 100 mtpa and then from 100 mtpa to 200 mtpa.⁴⁶

ii) Goonyella System Capacity

7.25 QR estimates that when the currently endorsed projects for the Goonyella system (Coppabella - Ingsdon duplication and Jilalan Yard upgrade) are completed, the network capacity will be 129 mtpa in cargo assembly mode. The throughput for 2008/09 was 87 mtpa.⁴⁷ There is scope to increase capacity by reducing the train separations. This has occurred, to some extent, with the completion of works associated with new feeder stations at Mindy and Bolingbroke. Further reductions in separation can occur through operational changes such as signalling.

7.26 Even further reductions in separation would require additional refuge loops and progressive triplication between Hay Point and Coppabella with intermediate signalling and power system upgrades. A fully triplicated system to Coppabella could handle approximately 230 mtpa of throughput. If both the existing ports at Hay Point were upgraded to maximum capacities they would require approximately 230 mtpa of rail capacity.

iii) Blackwater System Capacity

7.27 When the currently endorsed projects for the Blackwater system are completed, the track will be fully duplicated between Rocklands and Burngrove and the network capacity will be in the order of 85 mtpa.⁴⁸ The throughput for the Blackwater system in 2008/09 was 50.7 mtpa. The work, which is part of a currently endorsed project as detailed in the CRIMP, is planned to be completed in 2013 prior to the planned commissioning of the Wiggins Island Coal Export Terminal Stage 1.

iv) Moura System Capacity

7.28 The Moura system capacity is approximately 17 mtpa and has previously hauled about 11.3 mtpa of coal to the Gladstone precinct ports and domestic users.⁴⁹

7.29 QR has estimated that in the future the Moura system may be required to haul over 80 mtpa of coal from mines in the Moura, Monto and Surat areas. The bulk of this expansion is expected to be through the Surat area. To haul these tonnages the bulk of the Moura system

⁴⁵ See 'Annexure 6' to these applications.

⁴⁶ CRIMP at p 27

⁴⁷ CRIMP at p 28

⁴⁸ CRIMP at p 29

⁴⁹ CRIMP at p 30

would require some duplication, loop extensions, new passing loops and formation strengthening.⁵⁰ QR estimates that the Moura system is capable of being expanded by upgrading the tracks to handle the increase in tonnage being driven predominantly by Surat Basin coal mines. Potential then still exists to reduce headways which would further increase capacity. However, detailed consideration of this is yet to be undertaken.⁵¹

7.30 When the Moura and Blackwater potential system capacities are combined, the total rail capacity to Gladstone Port will exceed 240 mtpa. This exceeds the combined port capacity of RGTCT and the planned Wiggins Island Coal Export Terminal which is 165 mtpa.

d) Demand Estimates

7.31 Set out below is a table showing the history of coal tonnage railed to ports on the respective coal systems.

Export Port	Rail System	2005/2006	2006/2007	2007/2008	2008/2009
Gladstone Exports					
	Blackwater	39.5	43.6	46.4	44.7
	Moura	6.3	7.9	8.1	8.2
	Ex Goonyella				3.4
RGTCT		40.4	45.0	49.9	52.4
BPCT		5.3	6.5	4.6	3.9
Gladstone Export Totals		45.8	51.5	54.5	56.3
Domestic	Blackwater	5.7	5.7	6.0	6.0
	Blackwater Totals	45.2	49.5	52.4	50.7
Domestic	Moura	3.8	3.8	3.5	3.1
	Moura Totals	10.1	11.7	11.6	11.3
Hay Point Exports					
	Goonyella	82.4	87.8	81.6	83.1
DBCT		50.8	50.6	43.8	47.3
HPSCT		31.6	37.2	37.8	35.8
Hay Point Export Totals		82.4	87.8	81.6	83.1
Abbot Point Exports					
	Newlands	11.6	11.2	11.7	14.2
	via Goonyella/NCL			1.2	0.5

⁵⁰ CRIMP at p 30

⁵¹ CRIMP at p 30

Export Port	Rail System	2005/2006	2006/2007	2007/2008	2008/2009
APCT		11.6	11.2	12.9	14.7
Abbot Point Export Totals		11.6	11.2	12.9	14.7
	Goonyella Totals	82.4	87.8	82.8	86.5
	Newlands Totals	11.6	11.2	11.7	14.2
Brisbane Exports					
	Western System	4.1	3.8	5.4	6.1
Port of Brisbane		4.1	3.8	5.4	6.1
Brisbane Export Totals		4.1	3.8	5.4	6.1
Domestic	Western System	0.5	0.5	0.1	0.0
	Western System Totals	4.6	4.3	5.5	6.1
Total QLD Exports		143.9	154.3	154.4	160.2
	All Rail Systems Total	153.9	164.3	164.0	169.3

7.32 Wood Mackenzie estimated total export demand for Queensland coal of 294 mtpa by 2020. This represents an increase of 140 mtpa from a base of 154 mtpa in 2009. Industry capacity requests significantly exceed that amount. The industry capacity requests come from the 2009 CRIMP and are as follows:

Port Precinct	Current Capacity	mtpa increase by 2020	New total by 2020 mtpa
Abbot Point	25	61	86
Hay Point	129	99	228
Gladstone	76	149	225
Brisbane	5	10	15
TOTAL	235	319	554

7.33 **[Commercial in Confidence]**

7.34 QR has indicated in the CRIMP that it considers the industry capacity requests to be in excess of likely demand and has used the Wood McKenzie demand estimates as the basis for its infrastructure planning.⁵² Pacific National agrees that this assessment is reasonable and considers that the Wood McKenzie demand estimates should be used as the basis for assessing reasonably foreseeable demand for the purposes of Criterion (b).

⁵² CRIMP at p 20 - 22

e) Conclusions on Criterion (b)

7.35 In Pacific National's submission each of the four systems has, with the current committed projects sufficient capacity to meet likely demand for the Services.

	Demand			2008/09 Throughput (mtpa)	Capacity (mtpa)
	2010	2015	2020		
Newlands	16.72	37.92	86	14.2	50 (with potential to expand to 100, then 200)
Goonyella	94.46	146.76	228	87	129 (with completion of Coppabella - Ingsdon duplication and Jilalan yard upgrade) 230 (with triplication)
Blackwater	57	102.41	183.99	50.7	85 (with completion of duplication between Rocklands and Burngrove)
Moura	12.70	22.82	41	11.3	17 (with potential to increase to 85)

7.36 The costs of the proposed projects are substantial. Information on those costings is contained in the CRIMP⁵³. However, given the inherent characteristics of the rail infrastructure used to provide the Services as described in paragraphs 7.13 - 7.16 of these applications, the costs of expansion, whilst significant, are less than the costs which would be involved in construction of duplicate facilities.

7.37 Consistent with the position which the Council has previously adopted, the railways at issue here exhibit natural monopoly characteristics. As such, continued expansion of an existing facility will involve less cost than the construction of a new facility across a wide range of demand levels.

8. Criterion (c) —national significance

A. Legal Requirements

8.1 Section 44G(2)(c) of the TPA (**Criterion (c)**) requires that the Facilities be of national significance having regard to one or more of the following matters:

- (i) the size of the facility;
- (ii) the importance of the facility to constitutional trade or commerce; or
- (iii) the importance of the facility to the national economy.

⁵³ See chapters 8 and 9

B. Application of the law to the facts

- 8.2 Each of the Facilities to which the respective Services relate meet each of the elements in Criterion (c).
- 8.3 The Blackwater System consists of 994 km of bi-directional railway track of which 823 km is electrified. In 2008/09 the throughput for the Blackwater System was 50.7 mtpa representing exports valued at approximately \$4.664 billion.⁵⁴
- 8.4 The Goonyella System consists of 924 km of bi-directional track all of which is electrified. Its throughput for 2008/09 was 87.0 mtpa representing exports valued at approximately \$8.004 billion.⁵⁵
- 8.5 The Moura system consists of 301 km of single line track and passing loops. Its throughput for 2008/09 was 17 mtpa representing exports valued at approximately \$1.564 billion.⁵⁶ It is anticipated that it will be required to haul over 80 mtpa in the future.
- 8.6 The Newlands system consists of 203 km of single line track. In 2008/09 it had throughput of 14.2 mtpa with current capacity of approximately 19 mtpa representing export value of approximately \$1.306 billion.⁵⁷
- 8.7 Furthermore, as discussed in section 7.17 above, the total DORC value as at 30 June 2009 for these four systems is approximately \$2.86 billion, illustrating both the significant size of these systems and the huge costs that would be required to replicate these facilities.
- 8.8 Consequently, each of the Facilities which provide the Services sought to be declared are of national significance due to their significant size and importance to both Australian trade and commerce, and the national economy, as a result of the large volumes and value of throughput for export which is hauled on each of the Facilities to meet the increasing global demand for coal.

9. Criterion (d) - human health or safety

A. Legal Requirements

- 9.1 Section 44G(2)(d) of the TPA (**Criterion (d)**) requires that the Council be satisfied that access to the Services can be provided without undue risk to human health and safety. The

⁵⁴ This value was obtained using the average market price of coal (\$92 per tonne) quoted in the O'Donnell Goonyella Coal Supply Chain Capacity Review (2007) at p 5.

⁵⁵ This value was obtained using the average market price of coal (\$92 per tonne) quoted in the O'Donnell Goonyella Coal Supply Chain Capacity Review (2007) at p 5.

⁵⁶ This value was obtained using the average market price of coal (\$92 per tonne) quoted in the O'Donnell Goonyella Coal Supply Chain Capacity Review (2007) at p 5.

⁵⁷ Ibid.

Council has previously stated⁵⁸ that this involves a consideration of the nature of the potential risks associated with access and whether access can be provided in a manner that removes or appropriately manages any such risks.

B. Application of the law to the facts

9.2 In Queensland the *Transport Infrastructure Act 1994* and associated regulations establish a scheme for rail safety accreditation which apply to the Facilities and the Services. The relevant regulator is the Department of Transport and Main Roads.

9.3 Pacific National currently complies with all applicable laws and regulations including the *Transport Infrastructure Act 1994* and the regulations made under it in respect of its coal operations in Queensland. It will continue to adhere to its legislative health and safety obligations and operate in accordance with best practice in the event that the Services are declared. Consequently, the Council should be satisfied that declaration of the Services can be provided without any undue risk to human health and safety.

10. Criterion (e) - effective access regime

A. Legal requirements

10.1 Section 44G(2)(e) of the TPA (**Criterion (e)**) requires the Council to consider whether access to the service is already the subject of an effective access regime. Infrastructure services already covered by an effective access regime cannot be declared under Part IIIA of the TPA. This recognizes the role that State and Territory governments can play in developing industry specific access regimes and provides for their application to the exclusion of Part IIIA of the TPA where they comply with the principles contained in the Competition Principles Agreement (**CPA**).

10.2 A regime may be certified as effective pursuant to the provisions of ss. 44M and 44N of the TPA. Once a State or Territory access regime is certified as an 'effective access regime', it must be considered an 'effective access regime' under Part IIIA, with the result that Criterion (e) is not satisfied, unless the Council believes the regime or the principles contained in clause 6 of the CPA have been substantially modified since the certification.

10.3 However, under the current legislative provisions,⁵⁹ a State or Territory access regime may be considered an effective access regime for the purposes of s.44G(2)(e) even if it has not been the subject of a Commonwealth Ministerial decision regarding its effectiveness. The Council therefore, in the context of a declaration application, needs to undertake an

⁵⁸ See [7.1] of the Hamersley Final Recommendation.

⁵⁹ However, under the proposed amendment to section 44G(3) of the TPA contained in the *Trade Practices (Infrastructure Access) Bill 2009* (Schedule 5, Part 1, Clause 6), which is expected to be passed by Parliament shortly, a State or Territory access regime may only be considered 'effective' by the Council for the purpose of satisfying Criterion (e) if it has been certified as an effective access regime under section 44N of the TPA.

equivalent analysis to that which it would undertake in considering certification of those aspects of the Queensland regime which apply to the service of which declaration is sought.

10.4 The Queensland Rail Access Regime, has not been certified as effective by the Commonwealth Minister (and is not currently the subject of an application for certification). Accordingly, the Council must assess its effectiveness as part of its consideration of the application for declaration.

10.5 In its assessment, the Council:

- must apply clauses 6(2) - (5) of the CPA (**clause 6 principles**);
- must have regard to the objects of Part IIIA, and
- must, subject to s 44DA of the TPA, not consider any other matters, as per s 44G(3) of the TPA.

10.6 An effective access regime may also contain additional matters that are not inconsistent with the clause 6 principles.

Clause 6 Principles

10.7 For a regime to conform to the principles set out in clause 6 of the CPA it should:

- apply to services provided by means of significant infrastructure facilities where:
 - (i) it would not be economically feasible to duplicate the facility;
 - (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market;
 - (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and
- reasonably incorporate each of the principles in subclause (4) and, other than for certain specific access regimes which are not relevant here, subclause (5).⁶⁰

Clause 6(3) of the CPA notes, "There may be a range of approaches available to a State or Territory party to incorporate each principle. Provided the approach adopted in a State or Territory access regime represents a reasonable approach to the incorporation of a principle in subclause (4) or (5), the regime can be taken to have reasonably incorporated that principle for the purposes of paragraph (b)."

⁶⁰ Clause 6(3) of the CPA.

10.8 In the context of the Queensland Rail Access Regime, the relevant principles from sub-clauses (4) and (5) of clause 6 of the CPA are:

- (i) paragraph (4)(c) - any right to negotiate access should provide for an enforcement process;
- (ii) paragraph (4)(e) - the owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access;
- (iii) paragraph (4)(f) - access to a service for persons seeking access need not be on exactly the same terms and conditions;
- (iv) paragraph (4)(g) - where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so;
- (v) paragraph (4)(i) - in deciding on the terms and conditions for access, the dispute resolution body should take into account:
 - A. the owner's legitimate business interests and investment in the facility;
 - B. the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
 - C. the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
 - D. the interests of all persons holding contracts for use of the facility;
 - E. firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
 - F. the economically efficient operation of the facility; and
 - G. the benefit to the public from having competitive markets;
- (vi) paragraph (4)(m) - the owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person;

- (vii) paragraph (4)(n) - separate accounting arrangements should be required for the elements of a business which are covered by the access regime;
- (viii) paragraph (4)(o) - the dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service;
- (ix) paragraph (5)(a) - objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets;
- (x) paragraph (5)(b) - regulated prices should be set so as to:
 - ...
 - A. sub-paragraph (5)(b)(iii) - not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.

10.9 The status of the CPA principles as guidelines and the terms of paragraph (6)(3) make it clear that the principles are not to be applied in a pedantic way. Rather, the clause 6 principles, individually and taken together, reflect the overall objective which Part IIIA and individual access regimes are themselves intended to achieve, namely the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets. Given that objective is a matter specifically required to be incorporated into an effective access regime and guides the operation of Part IIIA itself, the principles themselves should be interpreted having regard to that objective.⁶¹

(a) **CPA Principles must be considered in context of the relevant markets**

10.10 The role of the principles as guidelines is also consistent with the fact that the effectiveness of an access regime needs to be judged against the underlying market conditions which exist. State and Territory access regimes apply to a wide range of different structural market conditions and need to be crafted to ensure they deliver their objectives in light of what those market conditions currently are and what they will be over the life of the regime.

10.11 The particular market conditions which exist for rail haulage in Queensland are:

⁶¹ *McCann v. Switzerland Insurance Ltd* (2000) 203 CLR 579; *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 201 CLR 181.

- (i) a vertically integrated rail provider which owns the relevant rail track and is currently Government owned;
- (ii) a proposed privatisation which will retain the vertically integrated structure for QR with a long term lease over the relevant rail track. Even if it is assumed that the lease of the track and the track management will occur within a subsidiary (which is not presently clear), the board of that subsidiary is required by its corporate governance arrangements required to be controlled by the CEO and CFO of QR;
- (iii) a relatively small number of potential customers; and
- (iv) the fact that demand for the haulage of coal from mine to port is largely insensitive to transport cost, as long as the FOB price of coal covers both the rail transport costs and the cost of mining.

10.12 In this environment, QR has an incentive to engage in discrimination in order to increase its revenues by reducing above-rail competition by:

- creating barriers for independent train operators to win contracts for new capacity, as demand for coal transport grows; and
- locking-in existing QR contracts and making it difficult for coal mines to switch to independent rail operators.

10.13 The effectiveness of the regime therefore has to be addressed by looking at the extent to which it fulfils the principles against the context of the incentives which QR faces, now and in the future, to reduce above rail competition and the ownership structure which exists and will exist in the foreseeable future.

(b) **CPA principles require non-discrimination by vertically integrated access provider**

10.14 In this context, a critical issue is ensuring that non-discriminatory access is available for third party train operators. The need for non-discriminatory access is recognised both expressly and by necessary implication in the clause 6 principles.

10.15 It is addressed directly in particular price setting principles which apply where there is a vertically integrated access provider. Paragraph 6(5)(b)(iii) of the CPA expressly requires that regulated access prices should be set so as not to allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.

- 10.16 The notion of non-discrimination is implicit in various other principles⁶² and is a necessary implication when those principles are interpreted in the context of the particular market structure which is under consideration in the present applications.
- 10.17 Clause 6(4)(m) contains a prohibition on hindering access. The notion of "hindering" is well known to competition law with the expression being used in a range of sections including ss. 4G, 45D and 46 of the TPA. The term "hindering" has been interpreted by Australian courts to mean in any way affecting usual access to an appreciable extent: (see *Australian Builders' Labourers' Federated Union of Workers v J-Corp Pty Ltd*⁶³ and *Devenish v Jewel Food Stores Pty Ltd*⁶⁴ (**Devenish**). In *Devenish* at [45] Mason CJ discussed the meaning of "hinder" as follows:

"Further, it cannot be, and indeed was not, suggested in argument that the notion 'direct' is inherent in either of the words 'hinder' or 'prevent'. Hinder has been construed in England in the general sense of in any way affecting to an appreciable extent the ease of the usual way of supplying the article."

- 10.18 The Council itself recognises discriminatory access by a vertically owned service provider is a classic way in which access could be hindered, and consequently in order to be effective, an access regime would need to address the potential for such discrimination:

"In the case of vertically integrated service providers, access may be hindered in circumstances where the service provider unfairly provides favourable terms of access to its affiliated entity. In rail, for example, a vertically integrated rail track operator that provides track priority and the most favourable track use timetabling to its own above-track operator may effectively hinder access to the rail track by other above-track operators. Such conduct would be contrary to clause 6(4)(m). Where there are vertical integration issues it may be necessary for an access regime to address the issue through, for example, ring-fencing and competitive neutrality provisions. Another way for states and territories to approach the issue may be to address vertical integration directly through structural separation."⁶⁵

- 10.19 The QCA Act recognises this in section 104 of the QCA Act which prohibits an access provider or user of a declared service from engaging in conduct for the purpose of preventing or hindering a user's access to the declared service under an access agreement, and specifically identifies the granting of access by the service provider to itself on more favourable terms as amounting to a hindering of access. However, there are two flaws in the way in which that provision operates.

- 10.20 First, it applies only where an access seeker already has access under the terms of an access agreement. Secondly, and more significantly, an access provider expressly does not contravene this prohibition if the conduct is undertaken pursuant the terms of an approved access undertaking. Accordingly, if the undertaking does not contain a prohibition on

⁶² The fact that it is implicit does not make it any less substantive. Rather, it reflects the fact that the principles are general principles and need to be adapted to the particular situation which is being examined

⁶³ (1993) 42 FCR 452.

⁶⁴ (1991) 172 CLR 32.

⁶⁵ See [3.189] of the National Competition Council's 'A guide to Certification under Part IIIA of the Trade Practices Act 1974 (Cth)' (May 2009) (**Certification Guide**)..

preferential treatment, then such conduct will not contravene s.104 of the QCA Act. Clearly a regime which purports to prohibit such discrimination in its legislation but then permits it through an access undertaking which is inconsistent with the legislation cannot be regarded as effective.

c) Needs to be an enforceable mechanism to facilitate access

10.21 The obligation to use "all reasonable endeavours to accommodate the requirements of persons seeking access"⁶⁶ coupled with the requirement for an "enforcement process"⁶⁷ (which is separate from the dispute resolution process required under clause 6(r)(a)) means that the access regime needs to have a structure and mechanisms within it which are designed to facilitate third party access and that an access seeker has a mechanism by which it can enforce those mechanisms.

10.22 As explained above, the incentives and the ability to engage in behaviours which reduce competition will depend on the particular market conditions, including ownership arrangements. Hence, an effective regime must enable access seekers to take enforcement action against the particular behaviours which are not consistent with reasonable endeavours to accommodate access, but which may arise due to the market conditions. If the regulatory regime has significant gaps which enable such behaviours to persist, then it does not meet the clause 6 principles set out in the CPA.

B. Application of the law to the facts

Operation of the QCA Act

10.23 Division 7 of the QCA Act provides for the owner or operator of a declared service to provide an access undertaking to the QCA either voluntarily or pursuant to the terms of a notice issued by the QCA. QR has voluntarily provided such an access undertaking. The first access undertaking provided by QR was approved in December 2001 after three years of review, consultation and discussion. Subsequently, access undertakings have been submitted and subject to review processes in 2006 and 2008 and consultation is currently underway on a new access undertaking, with QR initially submitting the 2009 Draft Access Undertaking in September 2008 before withdrawing this undertaking and recently lodging a revised 2010 Proposed Access Undertaking with the QCA for consideration. That process has not been concluded.

Application of QCA Act to the Services

10.24 Section 44G(2)(e) requires the Council to be satisfied that access to the service (of which declaration is sought) is not already the subject of an effective access regime.

⁶⁶ Competition Principles Agreement clause 6(4)(e).

⁶⁷ Competition Principles Agreement clause 6(4)(c)

- 10.25 The service of "the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating a railway for which Queensland Rail, or a successor, assign or subsidiary of Queensland Rail, is the railway manager" is declared for the purposes of s.97 of the QCA Act for so long as the rail transport infrastructure remains a public facility. It will continue to be a public facility whilst there is partial Government ownership.⁶⁸
- 10.26 It is, however, unclear what is proposed in the context of the restructuring of QR for the purposes of the IPO given the announced changes do not anticipate most of the relevant track remaining within the control of QR but moving into a separate entity, QR National Limited, which will then be listed via an IPO.⁶⁹
- 10.27 The Queensland Government has indicated that it proposes initially to hold a 25-40% stake in the privatised entity but that it would sell that interest down over time. At which point, even if the declaration which is currently in place by regulation under the QCA Act was contemplated to continue, it would only be in force until that sell down occurs. When and how that occurs is not subject to any regulatory review or any commitment to put in place appropriate regulatory arrangements for the future.
- 10.28 There is, therefore no certainty about what, if any, regulatory arrangements will apply to the Facilities the subject of these applications upon privatisation. As the legislation and regulations are currently drafted, in combination with the announced structure of the IPO, the Services for which declaration is sought in these applications will not be the subject of any declaration under the QCA Act once the Queensland Government has sold its stake in QR National Limited (as the Facilities which provide the Services will no longer be 'public' facilities to which the declaration applies as defined under the QCA Act). In Pacific National's submission, that, in itself, is a sufficient basis on which the Council should conclude that there is no effective access regime which applies to the Services the subject of these applications.
- 10.29 Alternatively, that is a basis on which the regime should be regarded as not being effective. If the regime is not sufficiently robust to deal with major expected market developments, such as privatisation, it cannot be regarded as being effective.
- 10.30 The QCA has itself acknowledged the problems which arise with the interface between the existing regulatory arrangements and the proposed privatisation. In its review of the 2009 Draft Access Undertaking⁷⁰, the QCA said:

"In considering this matter, the Authority accepts that these circumstances may change. In particular, the Authority is aware that the Queensland Government has

⁶⁸ See the Schedule to the QCA Act which defines 'public facility' (for the purpose of declaration under section 97) as meaning 'a facility owned (whether legally or beneficially and whether entirely or in part) by the State or a government agency, and includes a facility owned by a water authority.'

⁶⁹ According to QR's 'Scoping Study Outcomes' document (available at <http://www.qld.gov.au/assetssale/docs/queensland-rail-scoping-study-outcomes.pdf>), the Newlands, Moura, Goonyella and Blackwater coal tracks will be offered in the IPO as a long-term lease.

⁷⁰ As noted earlier this 2009 Draft Access Undertaking has subsequently been withdrawn by QR and replaced with the 2010 Proposed Access Undertaking.

*announced that significant parts of QR Network and QR Ltd will be offered to the market for sale. Under such circumstances, it is possible that separate, independent corporate entities will own declared rail infrastructure in Queensland. However, the timing and the result of that sale process are uncertain at this time. Therefore, the Authority must consider this matter based on the circumstances that currently exist."*⁷¹

- 10.31 For this reason, the QCA has not to date considered whether the Proposed Access Undertaking would be consistent with key competition principles following privatisation. The 2010 Proposed Access Undertaking contains some changes but those changes are at the margins and do not go to the issues raised by the QCA as described above.
- 10.32 In Pacific National's submission, this is a major weakness of the Draft Access Undertaking and the 2010 Proposed Access Undertaking. In effect, the QCA confirms that the regime is not designed to be robust to the evolution of the market. As set out in the Castalia Report, privatisation will create strong incentives for QR National Limited to use every available means to reduce above-rail competition. As a result, it is likely that the Queensland above-rail market for coal haulage is likely to become less competitive than it is today. Future barriers to entry are also likely to be higher than the current barriers to entry.
- 10.33 The fact that the Proposed Access Undertaking is not fundamentally robust to successfully adapt to major expected market developments, such as privatisation, is a key failure of the regime and makes it non-compliant with the requirements of the CPA and the objectives of Part IIIA.
- 10.34 Clause 6(3A)(a) of the CPA states that an assessing body should not, in its assessment of the effectiveness of an access regime under Part IIIA, consider "the outcome of any arbitration, or any decision, made under the access regime." In this context "any decision" should be interpreted consistently with the concepts which precede it⁷² as being an inter partes decision such as an arbitration determination. This is particularly the case where, as here, fundamental elements of the regime are themselves contained in the QR Access Undertaking and where the undertaking can override the operation of the legislation: see for example clause 2.2 of the 2010 Proposed Access Undertaking as discussed in section 3.2.4 of the Castalia Report. In these circumstances, to look at the legislation without the undertaking could give rise to quite a misleading picture and cannot be what was intended by clause 6(3A)(a) of the CPA.
- 10.35 The QR Access Undertaking sets out detailed matters contemplated by the legislation which require consideration by the Council in order for it to properly determine whether the regime satisfies the relevant benchmarks. Consideration of the QR Access Undertaking is required in order for the Council to obtain an accurate and comprehensive understanding of how the regime operates in its entirety and subsequently determine whether it satisfies Criterion (e).

⁷¹See p 95 of the QCA Draft Decision on the QR Network 2009 Proposed Access Undertaking (December 2009).

⁷² *R v Neal, Regos & Morgan* (1947) 74 CLR 613; *Attorney-General v Brown* [1920] 1 KB 773.

Inadequacy of Queensland Access Regime

10.36 Including the QR Access Undertaking (or 2010 Proposed Access Undertaking) in a consideration of the adequacy of the regime, the Queensland Rail Access Regime still fails to meet the necessary requirements when analysed against relevant benchmarks. The reasons for this are set out in detail in section 5 of the Castalia Report.

10.37 In summary the regime is not effective in that:

- it does not ensure non-discriminatory access is available for third party train operators contrary to the requirements of the principles contained in clauses 6(5)(b)(iii) and 6(4)(m) of the CPA; and
- it does not have mechanisms which enable access seekers to take enforcement actions against the particular behaviours which are not consistent with reasonable endeavours to accommodate access, but which arise due to market conditions contrary to clauses 6(4)(e) and (c) of the CPA.

10.38 The Queensland Rail Access Regime currently permits discrimination by:

- (i) providing for key access decisions to be made by an organisation which clearly is not independent of the above-rail commercial interests (i.e. QR Network Pty Limited, with a board dominated by QR's most senior employees) with none of the widely accepted mechanisms to address the concerns which arise from this situation (see Castalia Report 5.1.1). This is directly inconsistent with the Council's own guidelines which state that *"ring fencing arrangements required in circumstances where there is a vertically integrated operator include measures to establish staffing arrangements between the facility owner and affiliated bodies that avoid conflicts of interest."*⁷³;
- (ii) it does not have a sufficient degree of transparency associated with the provision of information to access seekers (see Castalia Report 5.1.2);
- (iii) the rules relating to the provision of information and to various technical compliance conditions which may be imposed on access seekers do not prevent QR Network from treating its related downstream businesses more favourably. For example:
 - A. while QR Network is obligated to supply certain specific network information to access seekers, there is no prohibition on supplying more detailed and helpful information to related parties;

- B. there is no provision for an independent review of technical requirements and specifications in order to prevent QR Network from setting technical standards to favour its own downstream operator; and
- C. where queuing is involved, the rules do not set out a clear process for an access seeker to assess its position in the queue or to understand how its position in the queue may be determined relative to that of a QR Network related entity.

(see Castalia Report 5.1.3).

- 10.39 Notwithstanding having more extensive competition and regulatory issues to address, the Queensland Rail Access Regime is significantly weaker in providing for the development of effective competition and is less clear in the development of principles for the exercise of regulatory discretion (see Castalia Report 5.2).
- 10.40 The structural operation of the QR Network business and the ring fencing rules in the QR Access Undertaking do not provide any meaningful protection against QR Network acting in the interests of the vertically integrated QR group. The ring fencing arrangements in Part 3 of the QR Access Undertaking and the 2010 Proposed Access Undertaking focus mainly on the management of confidential information. There is no treatment of how conflicts of interest at the board and CEO level will be handled, or any of the other aspects of functional separation that are normally associated with ring fencing.
- 10.41 The board of QR will have a fiduciary duty to maximize the profits of the corporation overall. This will be particularly the case upon the privatization of QR. The QR board is likely to make the management team accountable for the performance of the group since the directors of wholly owned subsidiaries can act in the interests of the parent company rather than in the interests solely of the subsidiary. As the QR Network Board includes senior QR executives, the structure clearly allows and encourages QR Network to act in the interests of the vertically integrated group. This is an issue which could be addressed by the inclusion in the Constitution of QR Network of a clause which ensures that the board will act having regard only to the best interests of QR Network in specified access related matters. For those matters, the board of QR Network could be prevented from having regard to the interests of any of its related bodies corporate including QR National Limited.
- 10.42 In addition, the Queensland Rail Access Regime does not provide an effective general prohibition on discrimination between above rail operators. Pacific National's key concern is that with the exception of pricing, there is no positive obligation on QR Network not to discriminate between above rail operators. An effective access regime should include positive obligations on QR Network not to discriminate between above rail operators with

⁷³ Declaration Guide at [3.197]

respect to investment, access to associated facilities, amendment of network rules, access application processes and train control procedures and practices.

10.43 In these circumstances the Council cannot conclude that the Queensland Rail Access Regime is effective for the purpose of satisfying Criterion (e).

11. Criterion (f) - public interest

A. Legal Requirements

11.1 Section 44G(2)(f) of the TPA (**Criterion (f)**) provides that the Council cannot recommend that a service be declared unless it is satisfied that "*access (or increased access) to the service would not be contrary to the public interest.*"

11.2 This criterion does not require the Council to be affirmatively satisfied that declaration would be in the public interest. Rather it requires that it be satisfied that declaration is not contrary to the public interest. It enables consideration of the overall costs and benefits likely to result from declaration and the consideration of other public interest issues which do not fall within Criteria (a) - (e).⁷⁴

11.3 The Council has identified a range of factors which it will consider in the context of the public interest. These are without limitation to other matters which may be relevant in particular circumstances. They are:

- ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations, and access and equity;
- economical and regional development, including employment in investment growth;
- the interests of consumers generally or a of a class of consumers;
- the competitiveness of Australian businesses, and
- the efficient allocation of resources.⁷⁵

11.4 In addition, as noted in paragraph 6.6, Criterion (f) permits an examination of whether declaration should occur given the terms of access which are currently available and will continue to be available. In the present case that involves an assessment of whether fair and

⁷⁴ *Re Services Sydney Pty Ltd* [2005] ACompT7 at [192].

⁷⁵ See [8.34] of the Declaration Guide.

reasonable terms and conditions will be available from a privatised QR given the regulatory environment in which it will operate.

- 11.5 As the Council has previously noted, in answering Criterion (f) the Council is required to be satisfied that the overall costs to the Australian public that arise from access to the relevant service does not exceed the overall benefits.⁷⁶

B. Application of the law to the facts

- 11.6 For the reasons detailed in Section 6 above, declaration will lead to greater efficiency in the provision of coal haulage services in Queensland and will lead to Queensland coal producers being more effective competitors, particularly in the market for globally traded coking coal. Rather than being discouraged, investment, particularly efficient investment, in both below and above rail infrastructure is promoted by the existence of above rail competition.
- 11.7 To the extent that any argument is raised that declaration of the Services may impact upon the price which the Queensland Government receives from the privatisation of QR, this is not a cost to be taken into account under Criterion (f). Rather, any such argument reflects the fact that absent declaration, there will be an incentive and ability to limit the benefits which flow from the entry of third party operators.
- 11.8 In Pacific National's submission, the access regime resulting from declaration by the Council is likely to address the incentives resulting from vertical integration, and particularly the opportunity for non-price discrimination, which are currently not addressed by the Queensland Rail Access Regime:
- (i) Unlike the QCA, the ACCC will not be constrained from taking future incentives following the IPO into consideration in its arbitration;
 - (ii) The ACCC has greater expertise and experience in arbitrating on access issues under the conditions of vertical integration; and
 - (iii) Arbitration following the declaration would be able to address conduct and structural issues which are currently shielded in the Queensland Rail Access Regime by the existing access undertakings.
- 11.9 In declaring the Services, the Council would be creating a regulatory regime which will, to an extent, overlap with the existing regime under the QCA Act. In weighing up the public interest of the declaration, the Council will need to consider whether the additional economic costs which may be imposed by creating an overlapping regulatory mechanism would be offset by the improvements in competition resulting from the declaration. In Pacific National's submission, the benefits to competition outweigh the additional regulatory burden.

⁷⁶ See [9.17] of the Hamersley Final Recommendation.

- 11.10 The additional regulatory burden would arise from the fact that the declaration may create some uncertainty over the matters which could be resolved through arbitration by the ACCC under the TPA and those matters which would remain subject to the QCA Act, and may be covered by any residual Access Undertakings under that Act. Pacific National is alert to the costs of regulatory uncertainty, as well as the risk of inconsistent decisions on broadly related issues under the two regulatory frameworks. However, as noted in paragraphs 10.25 - 10.28 above, the current declaration under the QCA Act will cease to apply when the Queensland Government sells its interest in the new listed entity. It has announced that it proposes to do so and therefore any overlap issues will be of only limited duration.
- 11.11 However, the additional regulatory costs are not likely to be significant. First, arbitration under the TPA will cover all significant issues relating to the terms and conditions of access. Second, following declaration, it would be reasonable to expect the QCA to cooperate with the ACCC to align the overall access regime.
- 11.12 By contrast, there will be significant improvements to competition under an access regime which prevents non-price discrimination against an access regime which enables such discrimination to occur.

12. Duration of declaration

- 12.1 Given the nature of the assets, Pacific National seeks declaration of the Services for a period of 50 years.