

24 April 2019

Professor Flavio Menezes
Chairperson
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001
Submitted via QCA online portal

Dear Professor Menezes

Declarations review: Aurizon Network, Queensland Rail and DBCTM Cross Submissions

Pacific National (PN) welcomes the opportunity to provide a submission in response to the Queensland Rail (QR), Aurizon Network and DBCTM submissions on the QCA's declarations review draft decision – cross submissions.

There is nothing in the submissions which cause us to change our view, all criteria are satisfied. Accordingly, the coal handling and below-rail service provided by DBCTM and Aurizon Network respectively should be (re)declared, while the below-rail service provided by QR should be (re)declared.

PN's attached submission proves:

- The Deed Poll to give effect to the Access Frameworks put forward by QR and DBCTM are not a relevant counterfactual for the QCA's assessment of criterion (a).
- Even if they were to be given consideration, their appropriateness is undermined by the fact they can be unilaterally altered, provide no effective remedies or resolution options for access seekers/users, and (in the case of QR) allow it to take possession of an operator's train, at anytime and without consent.
- Despite alleged competitive constraints on monopoly behaviour through competition with road, below-rail access charges are higher on segments where QR states road is a practical and commercial alternative to rail transport.
- There is a clear cause and effect between declaration and material promotion of competition in dependent markets.
- A declaration period of at least 15 years is justified for each of the services, and the QCA could comfortably recommend declaration for at least another 20 years.

In making this submission, PN notes its views and positions are broadly aligned with the DBCT Users Group, Glencore, Peabody, Queensland Resources Council and the South West Producers. We support and endorse their submissions.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. Millar'.

Robert Millar
Regulation and Policy Manager

QCA declarations review

Pacific National's submission in response to the Queensland Rail, Aurizon Network and DBCTM submissions

Public

April 2019

Contents

	Page
1 Overview	2
2 Introductory comments	3
3 Comments on the QR submission	6
4 Comments on the DBCTM submission	17
5 Comments on the Aurizon Network submission	21

1 Overview

Pacific National (**PN**) thanks the QCA for the opportunity to comment on the submissions made by Queensland Rail (**QR**), Aurizon Network and DBCT Management (**DBCTM**).

For the reasons set out in this and our earlier submission, we generally support the QCA's draft recommendations, subject to comments on the term and scope of the declarations. The coal handling and below-rail service provided by DBCTM and Aurizon Network respectively need to remain declared, while the below-rail service provided by QR also needs to remain declared.

Despite the volume of material lodged by QR and DBCTM in response to the draft recommendations, there is nothing in their submissions which cause us to change our view that each of the declaration criteria are satisfied in respect of the services they provide. Their submissions cannot get around the simple fact they operate natural monopoly facilities, and allowing them to operate in an unconstrained manner would be damaging to competition in dependent markets.

Aurizon Network appears to accept the declaration criteria are satisfied in respect of the access services it provides. The only issues actively contested by Aurizon Network relate to the scope and term of declaration – issues we address in this submission.

In making this submission, PN notes its views and positions are broadly aligned with the DBCT Users Group, Glencore, Peabody, Queensland Resources Council and the South West Producers. We support and endorse their submissions.

Deed Poll frameworks put forward by QR and DBCTM

One new element of the QR and DBCTM submissions is the use of a Deed Poll to give effect to their proposed Access Frameworks. It seems clear these frameworks have been contrived to circumvent the declaration criteria (particularly criterion (a)), by manufacturing a counterfactual.

PN would be concerned if the Access Frameworks were to be accepted as the relevant counterfactuals. This could potentially set a precedent which allows access providers to construct a counterfactual to declaration in a way that best suits their case, while leaving flexibility to amend the framework in future.

Both the QR and DBCTM frameworks can be amended without QCA oversight, undermining their relevance as a counterfactual for the QCA's analysis of criterion (a). Given the scope for amendment, it should not be assumed these Access Frameworks will continue to operate in the form submitted. Rather, it would be reasonable to assume QR and DBCTM would seek to amend these frameworks in ways that allow them to exercise their monopoly power. Furthermore, users have not been consulted on these frameworks.

More fundamentally, PN would be concerned if the QCA oversight, dispute resolution and enforcement mechanisms were to be removed, as would occur if declaration were to be withdrawn and replaced with the proposed Access Frameworks. These Access Frameworks, which essentially provide for self-regulation by each of the monopoly service providers, should not be seen as a substitute for proper oversight by an independent expert regulator.

Term of the declarations

PN considers the fundamental economic features of the QR, Aurizon Network and DBCTM services will not change for at least the next 15 years. Indeed it is difficult to see these features changing for at least two decades; Aurizon Network plans beyond a 15 year horizon¹.

We therefore consider the QCA should recommend declaration of each service for at least 15 years. Indeed, we consider a 15 year term would be highly conservative, and the QCA could comfortably recommend declaration of each service for at least another 20 years.

2 Introductory comments

2.1 The 'redeclaration' task

PN has previously noted that the 'redeclaration' task is unique. The question of whether to re-declare a service has not arisen to date under the QCA Act.

In the context of a redeclaration inquiry, it is highly relevant to consider what benefits declaration has already delivered, including by providing a platform for entry and effective competition in dependent markets. The question then becomes whether these benefits would be likely to dissipate if declaration were to be removed, and whether potential further benefits (e.g. potential further growth of competition and entry of efficient firms) may be foregone.

The submissions by QR, Aurizon Network and DBCTM have sought to down-play the benefits of declaration and emphasise its administrative and compliance costs. In some cases (such as in the QR submission), other factors have been cited as potentially contributing to the growth of competition in dependent markets.

PN can offer a unique perspective in this inquiry. Declaration and effective regulation have facilitated entry and strong business growth for PN in Queensland. PN is a case study in how effective access regulation can promote effective competition, and in turn this competition benefits related markets and the broader economy. PN's experience demonstrates the potential for future entry and further promotion of competition if declaration is to continue.

PN is also acutely aware of the risks to the competitive environment if declaration were to be removed – as discussed below, PN anticipates a real risk that, if declaration were to be removed, infrastructure owners may exercise market power in a way damaging to competition in related markets in which PN operates. In our view, the benefits of effective regulatory oversight cannot be overstated. These extend well beyond merely constraining the prices that may be charged by a monopoly service provider. Declaration under the QCA Act ensures there is effective oversight by the QCA and access to resolution of disputes by an expert regulatory authority.

The transparency and rigour of the QCA provides all parties with a degree of certainty in relation to the future design of Access Frameworks and the way disputes will be resolved.

¹ Aurizon Network, Network Development Plan 2016-17, pp. 3-4

Declaration has also allowed for the imposition of important structural and behavioural constraints, such as ring fencing and non-discrimination rules, which have underpinned the growth of competition in related markets.

Competition in turn brings benefits such as increased operational efficiency and innovation in related markets. For example, when PN entered the coal transport market in the CQCN it introduced ECP² braking into this network which has resulted in ongoing operational benefits.

In making its final recommendation, it will be important for the QCA to carefully consider all of the benefits brought by declaration, and the risk these benefits would dissipate or be foregone in a future without declaration.

2.2 Process issues

As in all matters relating to infrastructure access, there is a significant information asymmetry between the facility owners (QR, Aurizon Network and DBCTM) and other stakeholders. The facility owners hold information important to the application of the declaration criteria, such as operational and cost information. It is therefore important all stakeholders have adequate time to consider and respond to submissions made by the facility owners.

However, we note, in some cases, the facility owners have raised new arguments and lodged large volumes of new material late in the process, as part of their responses to the QCA's draft recommendations. In particular, QR and DBCTM appear to have held back significant amounts of information until after the QCA issued its draft recommendations (nearly 12 months into the review process), and/or have changed their position on key issues. As discussed below, a key aspect to the new information lodged by DBCTM and QR is an attempt to re-frame the analysis of criterion (a) through their Deed Poll / Access Framework proposals.

The lodgement of large amounts of information late in the process makes it very difficult for other stakeholders to respond effectively. This is made even more difficult where key information is masked on confidentiality grounds (as is the case in QR's submission in particular).

PN has sought to respond to these new arguments and new material as best we can in the allowed timeframe. However, we remain concerned that not all of the material lodged by the facility owners can be properly tested, either due to its lateness and/or confidentiality restrictions.

The QCA should consider giving less weight to information submitted late in the process where it could have been submitted at an earlier stage, and/or where information cannot be tested by other stakeholders due to confidentiality restrictions.

2.3 The effect of declaration on rail haulage providers

The stable market environment created by declaration promotes efficient investment in the above-rail haulage market and promotes investment in below-rail infrastructure. PN's entry and expansion in Queensland was critically dependent on this stable regulatory environment.

² Electronically controlled pneumatic brakes which are a type of braking system offering operational advantages over traditional braking systems.

Benefits of declaration include certainty and transparency of access terms and conditions, including the existence of a standard access agreement facilitating negotiated agreements and resulting in the promotion of competition in dependent markets.

As declaration promotes investment in the above-rail haulage market, the environmental and safety benefits of freight on rail are promoted by declaration.

Producers are currently able to hold their own access rights and select their haulage provider. This current industry structure is itself a product of the effectiveness of declaration and regulation since 1997 – and it does not reflect the likely state of affairs in the absence of declaration.

Declaration has been critical to promoting effective competition and supporting efficient investment across key freight transport supply chains over the past twenty years. The experience of PN in Queensland over the last decade demonstrates how regulated access to rail track has been effective in creating an environment in which rail freight competition can develop and grow.

For example, rail haulage contracts used to be negotiated for customers in response to tenders for a specific task. The effect of declaration meant rail haulage providers could grow their business outside of specific tenders through investment.

Rail haulage providers could create business opportunities and new freight markets in intermodal and bulk to compete against road transport. The effect of declaration being, they could go to market with an offering knowing the certainty of access (on reasonable terms) was established; rollingstock procurement to service these markets could be invested with certainty and little risk of stranding – which is important because of Queensland's unique narrow gauge and electrified network.

Put simply, PN's ability to grow its business in Queensland has been critically dependent on the certainty in relation to the terms of access to key infrastructure resultant from declaration

The material impact of competition in the rail haulage market in Queensland since declaration includes:

- significant direct investment by rail haulage operators;
- increased volume throughput;
- increased supply chain focus to optimise annual volume throughput; and
- improved service quality as a result of innovation and ongoing investment by competing operators, including:
 - introduction of electronically controlled pneumatic (ECP) braking, which has delivered ongoing operational and capacity benefits for Queensland's coal transport supply chains;
 - increased locomotive power;
 - safer operation of over-length trains; and
 - innovation in the design and configuration of train consists.

Because these material benefits exist, declaration can create an environment for competition in new dependent markets through entry of efficient firms. For example, (and not limited to):

- wagon and locomotive maintenance services;
- engineering/planning consulting services;
- property development services such as regional terminals/hubs and port infrastructure;
- passenger rail/heritage operating services; and
- track integrity testing.

3 Comments on the QR submission

In large part, the QR submission repeats arguments made previously and addressed by the QCA in its draft recommendation. These include claims that QR is constrained from exercising monopoly due to (among other things) competition in downstream markets and the threat of regulation.

One new element of QR's submission is the use of a Deed Poll to give effect to its proposed Access Framework. It seems clear the Deed Poll and Access Framework have been contrived in an attempt to circumvent the declaration criteria (particularly criterion (a)), by manufacturing a counterfactual.

For reasons set out below (see section 3.1 and 3.2), we fundamentally disagree that the Deed Poll and Access Framework achieve this purpose. Even if one takes the Deed Poll and Access Framework as a genuine counterfactual, conditions for competition would be materially worse under this counterfactual, compared to a world in which declaration is maintained.

More fundamentally, PN would be concerned if QR's Deed Poll and Access Framework were to be accepted as the relevant counterfactual. This could potentially set a precedent which allows access providers to construct a counterfactual to declaration in a way that best suits their case, while leaving flexibility to amend the framework in future.

As discussed below, a particular concern for PN relates to the scope for QR to amend its Access Framework. This greatly undermines the relevance of the Access Framework, and is an indicator of the likely state of affairs in the absence of declaration. Given the scope for QR to amend its Access Framework, it should not be assumed it will continue to operate in the form submitted. Rather, it would be reasonable to assume QR would seek to amend its framework in ways allowing it to exercise its monopoly power.

3.1 The QR Deed Poll and Access Framework

QR claims its proposed Access Framework would provide “*as much regulatory certainty for access seekers and access holders as currently exists*”.³ PN does not share this view, and we do not draw comfort or certainty from the proposed Access Framework.

The table below demonstrates QR's claim cannot be supported, by reference to examples of the differences between the regime that would be in place with declaration (based on the current access undertaking) and the regime QR has proposed should be put in place in the absence of a further declaration by the QCA (in the form of its Deed Poll and Access Framework).

Element	Relevant clauses	Analysis
Dispute resolution & enforcement		
Determination of disputes	With declaration: Access Undertaking, cl 6.1.4 (“ Resolution by	Without declaration, disputes would be resolved by an agreed or appointed arbitrator, not the QCA.

³ QR submission, [196].

Element	Relevant clauses	Analysis
	<p>QCA”)</p> <p>Without declaration: QR’s proposed Access Framework, cl 6.1.5 (“Arbitration”)</p>	<p>Where the QCA is empowered to determine access disputes, there is much more certainty around how any issues in dispute will be considered and assessed. The QCA is transparent and rigorous in its approach to access matters, and has a track record in dealing with such matters. In addition to the various decisions that it is required to make in access matters, the QCA also publishes various research papers and other public documents outlining its approach to key access-related issues (e.g. in relation to the cost of capital). This transparency and rigour around the QCA’s approach provides all parties with a degree of certainty in relation to how disputes will be resolved.</p> <p>By contrast, where a third party arbitrator is appointed, there will be a high degree of uncertainty around how any dispute will be determined.</p> <p>It is also not clear the depth and breadth of the information a third party arbitrator would be able to review and whether parties are compelled to provide it. Furthermore, how would parties to the dispute be assured an arbitrator would have the requisite skills and knowledge to establish floor and ceiling prices or determine the initial regulatory asset base. Only an economic regulator can fulfil this duty effectively and independently.</p>
Initial steps for resolution of disputes	<p>With declaration: Access Undertaking, cl 6.1.3 (“Resolution by escalation”)</p> <p>Without declaration: QR’s proposed Access Framework, cl 6.1.4 (“Resolution by senior management”)</p>	<p>In a scenario with declaration, the process for resolving a dispute following the provision of a Dispute Notice has multiple steps. The access undertaking mandates three meetings between progressively more senior representatives of the parties in dispute, providing staggered opportunities for resolution. QR’s proposed Access Framework only provides for one meeting between representatives of the parties before arbitration is triggered.</p>
Remedies / enforcement options	<p>With declaration: QCA Act, s 158A(3) (“Orders to enforce approved access undertaking”)</p> <p>Without declaration: Deed Poll, cl 4 (“Access Framework to Remain in Effect and Compliance with Access Framework”), cl 7 (“Breach of Deed Poll”); Access Framework cl 6.1.5 (“Arbitration”)</p>	<p>In the scenario with a declaration, the QCA is empowered to make orders directing the party in breach to comply with an undertaking.</p> <p>In the scenario without declaration, there is no provision in the Deed Poll, Access Framework or the applicable Resolution Institute Arbitration Rules which makes clear such a remedy would be available. Rather, an access seeker would need to enforce any rights it may have through court processes.</p>

Element	Relevant clauses	Analysis
Amendments to Access Framework		
Process for amendment of core access document	<p>With declaration: QCA Act, s 139 (“Requirement of responsible person to give draft amending access undertaking”), s 140 (“Consideration and approval of draft amending access undertaking by authority”)</p> <p>Without declaration: QR’s proposed Access Framework, cl 6 (“Amendments to Access Framework”)</p>	<p>The two scenarios are substantially different – under the current regime (with declaration), an amendment to the Access Framework must be approved by the QCA. QR’s proposal allows amendments to be made by QR itself, provided they are consistent with the Framework Objective and “appropriate” having regard to various considerations, and subject to consultation.</p> <p>Where there is scope for the access provider to vary its Access Framework, without regulatory oversight, this creates a high degree of uncertainty for access seekers regarding its future operation.</p>
Service standards & reporting		
Network repairs	<p>With declaration: Access Agreement, Schedule F, clause 7.1 (“Maintenance”)</p> <p>Without declaration: Access Framework, Schedule C, clause 2 (“Repairs, maintenance and upgrading of the Network”)</p>	<p>Under the regime proposed by QR, included in the Network Management Principles is a provision to the effect that QR would have the right to “at any time, without notice to a Rolling Stock Operator”, perform repairs, maintenance or upgrading of the Network, carry out any new work on the Network or take Possession” (subject to the qualifications in clauses 2(a) and (b), which include notification but not consent).</p> <p>By contrast, under current access arrangements, maintenance work is to be subject to agreed criteria and the Network Management Principles (as at Schedule F of the Access Framework). PN exercises its rights under these principles to ensure it delivers a competitive service for its customers.</p>
Reporting	<p>With declaration: Access Undertaking, cl 5.4.4 (“Audit”)</p> <p>Without declaration: Access Framework, Part 5 (“Reporting”)</p>	<p>Under the current access undertaking, the QCA may initiate an audit of reporting by QR. There is no similar provision in the regime proposed by QR.</p> <p>More generally, the reporting requirements are more rigorous in the current access undertaking.</p>

3.2 Criterion (a)

QR’s submissions on criterion (a) largely ignore the risk of hold-up due to the large, long-lived and sunk nature of users’ investments. This is a key reason why ongoing declaration and regulation of access will promote competition.

In the absence of declaration, the risk of hold-up will create uncertainty for potential market participants, raising the hurdle rate required to justify new investment and potentially preventing efficient entry and efficient participation in dependent markets.

The risk of hold-up is illustrated by the circumstances facing PN. PN has invested well over \$1 billion in above rail infrastructure in Queensland. Much of this infrastructure has very long lives and only recently deployed – QR's own North Coast Line Capacity Improvement Study 2015 identifies a relatively new fleet comprising 120 tonne Downer GT42CU Ace locomotives on this line⁴.

Rail investment is largely sunk, most of the infrastructure could not be deployed elsewhere if PN were to cease operating in Queensland. This is primarily because rollingstock is configured for electric infrastructure (which is unique to Queensland) and a narrow gauge track which is not widely deployed in Australia. Consequently, PN is in a very weak bargaining position when seeking to re-negotiate the terms of access with a monopoly supplier such as QR.

The risk of hold-up is not addressed by the QR Access Framework, nor is it mitigated by competition in downstream markets. It does not account for the important national monopoly regulation theory by Darryl Bigger⁵ of the ACCC who states:

“natural monopoly regulation exists to protect the sunk investments made by consumers of the regulated firm.”

“...the sunk investment hypothesis can explain why regulation may still be necessary for firms which do not even earn a normal rate of return. According to the sunk investment hypothesis the presence or absence of monopoly rents is not the primary drive of regulation – rather, it is the scope for hold-up. A firm may have significant scope to hold-up its customers even if it is earning below normal returns – and indeed, the customers of a firm may be particularly exposed to hold-up if that firm receives some external source of funding (subsidies) which can be withdrawn at any time.”

PN is both a customer of QR, and a dependent market participant.

Access Framework does not address the risk of hold-up

The hold-up risk is not addressed by the proposed Access Framework.

This is partly because, with scope for QR to make amendments over time, there would be a high degree of uncertainty for potential access seekers around what form of Access Framework would apply when it came to re-negotiation of access rights. Even to the extent the Access Framework as currently proposed might provide some protections for access seekers in negotiations with QR, access seekers can have no confidence these protections will still be in place when they come to re-negotiate access rights.

Moreover, as noted above, access seekers would not have access to dispute resolution by the QCA in the event of a dispute around re-negotiation. From PN's perspective, this is a critical mechanism for protection against the risk of hold-up.

Arbitration by a third party under the proposed Access Framework is not a substitute for resolution of disputes by the QCA. The rigour and transparency of the QCA provides access seekers with a high degree of certainty in relation to how any future disputes will be resolved.

⁴ North Coast Line Capacity Improvement Study – Final Report (Version 2.1 -16 March 2015

⁵ Bigger, Darryl. "Is Protecting Sunk Investments by Consumers a Key Rationale for Natural Monopoly Regulation?", p 1, 23-24

By extension, this also provides a degree of certainty around the future behaviour of QR, since this will be shaped by the expected approach of the QCA.

Relevance of competition in downstream markets

QR claims it faces “*intense and increasing competition from road operators*”⁶, and this competition constrains its behaviour.

QR argues that, where there is competition from road operators, this provides end customers with “*significant countervailing power, as the option of road transport means that they can make a credible threat to withdraw from negotiations*”.⁷

While there is competition between rail and road haulage in downstream markets, this does not eliminate the risk of hold-up or the associated risks to competition. Even where an above-rail operator faces competition from road haulage, it will still be in a very weak bargaining position when seeking to negotiate with the monopoly below-rail provider, and therefore the hold-up risk remains.

QR is the monopoly provider of rail track network access on key routes used by PN and other rail operators. PN has sunk investment into long-lived infrastructure, the use of which relies on access to QR’s below-rail infrastructure. Where customers require haulage along routes served by the QR infrastructure, and in order for PN to utilise its sunk assets, PN has no option but to acquire rail track network access from QR. This places QR in a position where it can exercise market power, and creates a hold-up risk for QR.

This is the case even where PN faces competition in haulage markets. Due to the sunk, asset-specific and long-lived nature of its investment, there is no real prospect of PN switching away from use of the QR infrastructure. Since PN must acquire access to the QR infrastructure in order to make use of own infrastructure, we have little choice but to accept the terms dictated by the monopolist. PN cannot credibly make a threat to withdraw from negotiations with QR, regardless of the degree of competition from road operators. To illustrate, consider the credibility of a threat by PN to stop using QR’s below-rail infrastructure and redeploy its rolling stock to offer freight services by road – such a threat clearly would not be credible, given the sunk, asset-specific and long-lived nature of PN’s investment in rolling stock and other above-rail infrastructure.

Consequently, PN is generally not in a position to negotiate better terms of access to QR’s infrastructure where it will use that access to supply freight services in competition with road. Indeed, PN’s terms of access are not distinguished between circumstances where it does and does not face competition from road. QR takes essentially the same approach to negotiating the terms of access across all the services it provides to PN, even though the degree of competitive constraint faced by PN varies by freight task.

In any event, PN considers QR (and its consultant, HoustonKemp) have significantly overstated the extent of the constraint on monopoly pricing by QR caused by competition between rail and road haulage. In particular:

⁶ QR submission, [9].

⁷ QR submission, [139].

- QR do not seek to offer more favourable terms to PN for those freight tasks that are subject to a degree of inter-modal competition. This reinforces the point made above, that even where there is competition between rail and road haulage in downstream markets, this does not appear to constrain QR's ability to exercise market power, nor does it eliminate the risk of hold-up.
- On the North Coast line which can be segmented into short (Brisbane to Rockhampton), medium (Brisbane to Townsville) and long (Brisbane to Cairns) the rail share to road is approximately 18, 27 and 61 per cent respectively.

However, despite the claim by QR about competition (acting as a constraint on monopoly pricing) on the short and medium segments, it does not change its behaviour. In fact, the QR access costs are the highest on the short and medium segments which compete with road (\$4.91 and \$4.60 respectively) with long haul segments being the lower access price - \$4.27⁸.

Given road is a competitive threat to rail, QR pricing behaviour (if wasn't a monopolist) would suggest lower access prices on these segments. Its pricing behaviour is contrary to QR's own assertion: "Road transportation offers an effective substitute service to rail, which has a significant and direct downward impact on the prices that Queensland Rail negotiates with access seekers⁹."

While the current undertaking approved by the QCA does constrain QR's pricing, PN asserts the QCA should approve benchmark access prices to address the imbalance between the operator/access seeker and QR when negotiating access prices by segment. We understand this approach has been used to success on the West Moreton line; with the operator/access seeker and QR being able to negotiate away from the price if there is agreement.

Relevance of spare capacity

QR repeats its claim that, due to spare capacity on its network, it would have incentives to maximise demand for below-rail services, and that this would provide some constraint on its ability and incentive to exercise market power.

This submission conflates the provision of access with provision of access *on reasonable terms*. While QR may face incentives to seek customers for its spare capacity, it will not be constrained in setting the terms of access to that capacity. On the contrary, QR will face incentives to maximise profits, and therefore may be expected to set unreasonable terms (as seen above, prices). Therefore the risk of hold-up remains, notwithstanding spare capacity in parts of the QR network.

Threat of regulation

QR claim the threat of future regulation will constrain its behaviour in a world without declaration.¹⁰

⁸ BITRE/ARTC 2014 estimates for road rail share. Access cost information is a calculation from QR published tariffs assuming 600m max length trains.

⁹ Queensland Rail, sub. 8, p. 1, para 3, 30 May 2018

¹⁰ Queensland Rail submission, [155].

The “threat of regulatory intervention” is not a substitute for regulation itself. The “threat of regulation” potentially hangs over every monopoly service provider, yet it does not constrain the exercise of monopoly power. In sectors where there is a threat of regulation only, monopoly service providers have been found to be exploiting their position, undeterred by the threat of future intervention.¹¹ The imposition of regulation also has a very long lead time so is not enough in itself to constrain damaging behaviour in the short to medium term.

Risk of ‘reputational damage’

QR seeks to dismiss the risk of hold-up, saying it does not have an incentive to take advantage of users in second round negotiations, since doing so would give rise to “reputational damage”.¹²

PN does not consider that a monopolist should be left unregulated, on the basis that it might be expected to self-regulate its behaviour to avoid reputational damage. Economic theory and experience tell us the risk of reputational damage will not constrain a monopolist’s behaviour. Rather, a monopolist will act on its incentive and ability to exploit its market power.

Addressing the hold-up risk has, and will continue to, promote efficient entry and competition

Declaration has been critical to promoting effective competition and supporting efficient investment in haulage markets over the past two decades. The experience of PN provides a clear example of how regulated access to below-rail infrastructure can create an environment which facilitates competitive entry. PN’s ability to grow its business in Queensland has been critically dependent on having certainty around the terms of access to below-rail infrastructure, and protection against hold-up risk.

QR seeks to down-play the role of declaration in supporting competition, citing other factors which may have contributed to PN’s entry decision.¹³ It appears to be suggested by QR that certainty around the terms of access to below-rail infrastructure played little or no role in PN’s decision, and that competitive entry would have occurred with or without effective regulatory oversight.

QR is not well placed to comment on the drivers behind past investment decisions made by other businesses. Accordingly, its submissions on this point should be given little weight. In any event, QR’s submission significantly understates the importance of certainty around the terms of access to below-rail infrastructure in supporting investment decisions by haulage providers. For example, rail haulage contracts used to be negotiated for customers in response to tenders for a specific task. The effect of declaration meant rail haulage providers could grow their business outside of specific tenders through investment.

Rail haulage providers could create business opportunities and new freight markets in intermodal and bulk to compete against road transport.

¹¹ For example, ‘uncovered’ gas pipelines have faced the threat regulation since inception of the pipelines access regime in the late 1990s. However, the ACCC has found that the threat of regulation under the access regime is not constraining the behaviour of pipeline owners (ACCC, *Inquiry into the east coast gas market*, April 2016, pp 10-12 and Chapter 7).

¹² QR submission, [191.2].

¹³ QR submission, [416].

The effect of declaration being they could go to market with an offering knowing the certainty of access (on reasonable terms) was established; rollingstock procurement to service these markets could be invested with certainty and little risk of stranding – which is important because of Queensland’s unique narrow gauge and electrified network.

When considering whether to invest and enter new markets, PN carefully considers the following:

Current frameworks for establishing the terms of access. Clearly, an important consideration is the current framework for determining access terms for below-rail infrastructure, since this will influence PN’s ability to obtain reasonable terms of access in the short-term. However, given the sunk and long-lived nature of any investment in haulage infrastructure, this will be far from the only consideration.

- **Re-contracting risk.** Since the term of initial access contracts will almost always be shorter than the life of haulage infrastructure, re-contracting risk will be a key consideration.

Where there is a risk of hold-up by a monopoly service provider at the time of re-contracting, this creates a material risk to the value of PN’s investment.

- **Access Framework expected to be in place at the time of re-contracting.** When assessing re-contracting risk, PN will consider the likely framework for determining terms of access at the time of re-contracting.

In particular, PN will consider whether there is likely to be effective regulatory oversight to constrain the exercise of monopoly power by the below-rail operator.

- **Dispute resolution mechanisms available to mitigate re-contracting risk.** Another important factor in assessing re-contracting risk is the availability of dispute resolution mechanisms. In the past, PN has taken great comfort from the fact that, in the event of a dispute with QR around re-contracting, dispute resolution by the QCA would be available. This has provided a high degree of certainty for PN, and protection against the risk of hold-up.

The level of service and performance of the network.

In addition to constraining QR’s ability to exercise monopoly power, declaration and regulation by the QCA also ensures rail track network access is delivered efficiently. In the absence of competitive pressures, monopoly businesses such as QR are likely to deliver poor service at high cost. This is particularly the case for businesses such as QR, which receive Government subsidies (meaning that the cost of any inefficiency is at least partly borne by taxpayers, rather than the business itself).

In the case of QR, this is currently addressed through performance standards and pricing rules set out in its approved access undertaking – for example, QR’s current access undertaking includes pricing principles which constrain (overall) QR to recovering only its efficient costs, network management principles, performance reporting requirements, and dispute resolution mechanisms which may be invoked in relation to price or non-price matters (including in relation to service performance). The QCA assesses the prudence of QR’s capital expenditure annually to determine whether the capital expenditure should be included in its regulatory asset base.

Ongoing regulation is required to ensure QR operates and provides access to its rail track network infrastructure efficiently – the disciplines currently imposed by regulation (such as non-discrimination and ringfencing) would not arise simply by virtue of QR's position as a statutory authority, the fact that some downstream customers may have more limited ability to pay, or the existence of spare capacity in some parts of the system.

For example, PN exercises its rights under the network management principles to hold QR to account for ensuring the safe and efficient operation of the network to meet the freight requirements of its customers. Without declaration, QR will seek (as it proposes in its Access Framework) to give itself the right “at any time, without notice to the Rolling Stock Operator” to take possession without consent.

This could severely impact on rail haulage operations, in particular the ability to plan effectively and with certainty for its customers. In other words, regulation is important to ensure service and performance on the monopoly network.

The importance of these considerations should not be down-played or understated. For a haulage provider such as PN, the terms of access to below-rail infrastructure (including, but not limited to, the price of access) have a material bearing on the viability of its operations and its ability to compete. Therefore, the potential for hold-up leading to a material deterioration in the terms of access presents a significant risk to its investment.

PN would therefore be concerned if the certainty offered by declaration and regulatory oversight were to be removed. The prospect that QR will have the ability to exercise market power in future negotiations will create uncertainty for both existing players and potential entrants (this applies equally to ‘the other systems’ which are interconnected with the broader system and identified by COAG Transport Infrastructure Council as key freight routes¹⁴). This will ultimately be damaging to competition in markets in which PN currently operates, and new markets providers could operate in (including on the other systems). As noted previously, declaration can create an environment for competition in new dependent markets through the entry of efficient firms. For example, (and not limited to):

- wagon and locomotive maintenance services;
- engineering/planning consulting services;
- property development services such as regional terminals/hubs and port infrastructure;
- passenger rail/heritage operating services; and
- track integrity testing.

Given that natural monopoly characteristics pervade the entire network, QR has the ability and incentive to exercise monopoly power across all of the services it provides, and all users (and all potential future users) face the risk of hold-up; declaration must remain.

3.3 Criterion (b)

QR's submissions on criterion (b) are without foundation. QR claims the QCA cannot be affirmatively satisfied on criterion (b), but no evidence is provided to address the QCA's positive findings regarding the scope of the market and QR's ability to meet foreseeable demand in this market at least cost.

¹⁴ Transport Infrastructure Council website, National Key Freight Routes.

Each of the matters which QR says ought to be considered by the QCA have been duly considered, and the QCA has reached an affirmative conclusion criterion (b) is satisfied.

If QR contends for a different conclusion on criterion (b) (and this is not clear from its submission), then it is incumbent upon it to present evidence to refute the QCA's conclusions. It has not done so.

3.4 Criterion (c)

QR accepts that at least parts of its network are of state significance, but argues that some parts are not so significant.¹⁵

PN considers that, if parts of the network are of state significance, then the network as a whole is similarly of state significance. QR should not be allowed to “slice and dice” the network, so as to identify parts which are arguably not significant.

PN continues to believe that declaration should remain in place for the entire QR network. We consider the key economic features of the North Coast Line, the Mt Isa Line and the West Moreton and Metropolitan systems which mitigate in favour of declaration apply equally to the other systems, and to the QR network as a whole.

As noted by the QCA, the other systems are interconnected. The Western system adjoins the far western section of the West Moreton system at Miles with Western system branch lines running directly off the West Moreton system. Freight traffic from the Western system traverses the West Moreton and south-east Queensland systems with grain and cotton railed to and pipes railed from the Port of Brisbane and livestock to Dinmore and Holmview.

The South Western system adjoins the West Moreton System at Toowoomba. The Central West system adjoins the Aurizon Blackwater system at Emerald. The West Moreton system adjoins south-east Queensland in the east at Rosewood and the far-west section of the Western system in the west at Miles.

In any event, PN considers that each part of the network identified by QR is significant in and of itself. Each plays a significant role in supporting the Queensland economy.

3.5 Criterion (d)

In a similar vein to its submissions on criterion (a), QR seeks to dismiss the very substantial public benefits delivered by declaration and effective regulation of access to its below-rail infrastructure. For reasons explained above, the benefits of declaration should not be underestimated. Declaration of the QR infrastructure has supported significant investment and competitive entry in dependent markets.

This has in turn delivered a number of economic, environmental and social benefits (including on the other systems), as explained in PN's previous submission.

¹⁵ QR submission, [387].

QR cites the cost of the QCA administering the regulatory regime applicable to declared facilities. Their submission refers to:¹⁶

- costs borne by the QCA in 2014-15 and 2015-16 of less than \$4 million; and
- costs borne by the industry (through the QCA Levy) of \$13.9 million in 2015-16 (of which QR contributed less than \$1 million).

Compared to the considerable benefits of declaration, these costs are very small. PN considers administrative costs with declaration are a small price to pay for constraining the exercise of monopoly power by QR, and supporting competition and ongoing investment in critical freight supply chains.

QR also complains of “*excessive prescription and unnecessary regulatory burden*” in the form of its 2016 access undertaking.¹⁷

To the extent this undertaking is unnecessarily prescription (and we do not accept that it is), this is not a matter relevant to the criterion (d) assessment. Any shortcomings in the form of access undertakings can be addressed through the DAU / DAAU processes – it is not a reason to not apply regulation at all.

3.6 Scope and term of declaration

We agree with the QCA that a term of at least 15 years would be appropriate.

QR submits that a much shorter declaration period of five years should be adopted.¹⁸ In support of this submission, QR refers to the report of its consultants, HoustonKemp, who suggest a “*shorter declaration period... say, of five or at most ten years*”.¹⁹

QR and HoustonKemp argue “*QR’s market circumstances have changed significantly in the past five years and will likely change even more in the next five years*”.²⁰ However the evidence cited in the HoustonKemp report does not support this proposition. On the contrary, the evidence paints a picture of relatively stable market conditions, albeit with some limited substitution between road and rail for specific freight tasks. For example, HoustonKemp notes that “*rail freight volumes on the North Coast line have been stagnant or in slight decline in the past eight or nine years, eg, rail freight has gone from around seven billion gross tonne kilometres of intermodal freight in 2011-12 to around 6.5 billion in 2017-18*”²¹ – this is hardly a dramatic change.

PN considers the fundamental economic features of QR’s network – in particular its natural monopoly characteristics, associated hold-up risk for users, and its significance to the Queensland economy – will not change for at least the next 15 years. Indeed it is difficult to see these features changing for at least two decades.

¹⁶ QR submission, [427].

¹⁷ QR submission, [428].

¹⁸ QR submission, [250].

¹⁹ HoustonKemp Report, p 4.

²⁰ HoustonKemp Report, p 3.

²¹ HoustonKemp Report, p 3.

We therefore support the QCA's draft recommendation for a 15 year declaration term. We consider this is highly conservative, and the QCA could comfortably recommend declaration of the below-rail service provided by QR for 20 years. The scope of declaration should include the other systems.

4 Comments on the DBCTM submission

4.1 Criterion (a)

DBCTM's submissions on criterion (a), like QR's, are underpinned by an Access Framework and Deed Poll. DBCTM states its Deed Poll and Access Framework should "*put beyond doubt*" that it cannot act in any way that will adversely impact competition in relevant markets in a world without declaration.²²

DBCTM is clearly seeking to circumvent criterion (a) and neutralise the concerns raised regarding its ability to exercise market power. Recognising that declaration has provided certainty for access seekers, DBCTM says its Deed Poll and Access Framework will "*preserve regulatory certainty*".²³

For reasons set out above in relation to the QR Access Framework, PN would be concerned if the DBCTM Deed Poll and Access Framework were to be accepted as the relevant counterfactual.

Under the Deed Poll, DBCTM may amend the framework from time to time, so long as these amendments promote the Framework Objective, and provided that DBCTM has had regard to certain "mandatory considerations".²⁴ Challenges to a DBCTM decision to make amendments would be limited to circumstances where the requirements of the Deed Poll have been breached – for example where a mandatory procedural step has not been taken, or where DBCTM has manifestly failed to take into account one of the mandatory considerations – and in such cases the DBCTM decision would need to be challenged in court.

Given the broad scope for DBCTM to amend its Access Framework, it should not be assumed it will continue to operate in the form submitted, and therefore it should not be seen to represent to the likely state of affairs in the absence of declaration.

In any event, the Deed Poll and Access Framework do not (and cannot) achieve the stated purpose of preserving regulatory certainty. As discussed below, DBCTM's proposed framework is in many ways inferior to declaration and effective regulation by the QCA. Most obviously, under the proposed Access Framework there would be no regulator to oversee amendments to the framework, determine the terms of access for new users (including prices) and resolve disputes. Rather, these matters will be left to DBCTM. It is difficult to see how regulatory certainty can be effectively preserved without the involvement of an independent regulator, and where the role of the regulator is largely usurped by the monopoly service provider.

In effect, DBCTM is asking the QCA and other stakeholders to believe it can self-regulate, or at least mimic regulation through its Deed Poll and Access Framework.

²² DBCTM cover letter [5].

²³ DBCTM submission, [401.2.2].

²⁴ DBCTM Deed Poll, cl 8.2.

This submission ought to be rejected. In circumstances where a monopoly service provider has the ability and incentive to exploit its position in ways damaging to competition in dependent markets, there is no substitute for proper regulatory oversight. DBCTM should not be allowed to sideline the QCA by putting forward a contrived framework for self-regulation.

Uncertainty under the DBCTM Access Framework

As noted above, a central theme of DBCTM's submissions is a claim that its Deed Poll and Access Framework will “*preserve regulatory certainty*”.²⁵

PN considers it inconceivable that regulatory certainty could be effectively preserved under the Deed Poll and Access Framework, given:

- **Scope for DBCTM to amend.** As noted above, DBCTM would have broad scope to amend its Access Framework, subject only to the “Framework Objective” and certain mandatory considerations. This creates a high degree of uncertainty around the future operation of the Access Framework, given the prospect DBCTM would seek to incrementally amend the framework to give it greater flexibility.
- **Pricing uncertainty.** Under the DBCTM Access Framework, maximum prices would be set by reference to the TIC that “*would apply... under a QCA administered pricing regime*”, plus a margin of \$3 per tonne. This clearly leaves room for argument around the approach that *would be* taken by the QCA on matters such as the rate of return, and hence uncertainty around what prices would be offered by DBCTM under this framework.

This would be compounded by uncertainty around the dispute resolution process (see next point), since any disagreement over price terms would be subject to this process.

- **Absence of QCA dispute resolution.** As noted above, access to dispute resolution under the QCA Act provides for certainty around how any issues in dispute will be considered and assessed. The QCA is transparent and rigorous in its approach to access matters, and has a track record in dealing with such matters. This transparency and rigour around the QCA's approach provides all parties with a degree of certainty in relation to how disputes will be resolved.

By contrast, where a third party arbitrator is appointed under the Access Framework, there will be a high degree of uncertainty around how any dispute will be determined.

- **Absence of QCA monitoring / enforcement.** In the absence of declaration, the QCA will not have powers to monitor and enforce compliance with the Access Framework. Users are also likely to have limited visibility of any breach by DBCTM of its Access Framework.

Likely effect of uncertainty on investment, entry and competition

DBCTM seeks to down-play the impact of uncertainty for prospective users under its proposed Access Framework.

²⁵ DBCTM submission, [18], [401.2.2].

It is claimed that “*terminal charges make up only a fraction of the costs (and risks) considered by a miner deciding whether to invest in a coal tenement.*” and that uncertainty regarding the terms and conditions of access at DBCT could not be so significant as to deter potentially efficient new entry in the coal tenements market.²⁶

DBCTM also says it would be “absurd” to suggest a \$3 per tonne price differential as between existing and new users could result in a material adverse impact on competition in the coal tenements market.²⁷

The effect of removing declaration would go well beyond a potential increase in the access price of \$3 per tonne. Of much greater significance would be the loss of certainty around terms of access more broadly, and the potential for dismantling of structural and behavioural constraints on DBCTM.

The QCA has correctly observed that uncertainty around future terms of access to port facilities is likely to be damaging to competition in the market for coal tenements. Further, it would discourage entry of efficient firms.

PN considers removal of declaration could also be detrimental to competition in rail haulage markets which connect with DBCT. As previously noted, declaration of services at DBCT has provided for important structural and behavioural constraints on DBCTM, which have supported the growth of competition in dependent markets, including rail haulage markets.

Although “ring fencing” provisions are included in DBCTM’s Access Framework²⁸, there would be the potential for DBCTM to amend or remove these protections. Accordingly, there would be a risk for potential entrants into rail haulage markets that existing protections on competition may be lifted over time. This risk could deter future entry and may ultimately be damaging to competition in rail haulage markets.

Relevance of DBCT being fully contracted

DBCTM states DBCT is now fully contracted. It is argued that, as a result, there is no prospect a potential new entrant to the coal tenements market could gain access to DBCT with or without declaration, and therefore declaration will have no impact on competition in this market.²⁹

This submission misunderstands the nature of investment in coal tenements. Tenements are often acquired well in advance of planned production and export, as they can take several years to develop and start production. Accordingly, a miner’s decision to invest in a coal tenement will have regard not only to current port / rail capacity and terms of access, but more importantly, to expected future capacity and access terms. In some cases, a miner may invest in a new tenement notwithstanding current port / rail capacity constraints, if it is expected that capacity will be available in future.

Over the proposed term of the declaration, it is likely new entrants will seek coal tenements, notwithstanding any immediate capacity constraints at DBCT. Within this period and beyond, competition for new tenements will be materially distorted if those new entrants face greater uncertainty around the future terms of access to DBCT.

²⁶ DBCTM submission, [190.4], [303].

²⁷ DBCTM submission, [347].

²⁸ DBCTM access framework, cl 8.

²⁹ DBCTM submission, [390].

4.2 Criterion (b)

PN agrees with the QCA's approach in its draft decision on the assessment of criterion (b), noting the steps of identifying the service, the facility, the market in which the service is provided, total foreseeable demand in the market, if the facility can meet the total foreseeable demand in the market, and the cost of the facility (as expanded where relevant) meeting that demand at least cost compared to the cost of any two or more potential suppliers meeting the foreseeable demand.

We agree with the DBCT Users Group, the QCA is not required to conduct a detailed analysis of the exact prospects or likelihood of a particular expansion proceeding – just whether the barriers and impediments to an expansion are such that they would make an expansion “impossible, theoretical or fanciful”³⁰.

In terms of the costs relevant to criterion (b), we agree with DBCT Users Group, costs should be construed widely.³¹ The QCA is correct in considering the additional costs of rail infrastructure, rail haulage and mine site infrastructure are all relevant costs for these purposes. This is particularly important to PN given its significant infrastructure spend.

Finally, we agree with DBCT Users Group, non-Goonyella terminals are not close substitutes for DBCT; marginal use of other terminals by Goonyella mines does not make them close substitutes and the Hay Point Terminal is not a substitute.

We support the QCA's finding that DBCT can clearly meet foreseeable demand in the market at the least cost compared to two or more facilities, and criterion (b) is satisfied

4.3 Criterion (c)

PN agrees with the QCA and DBCT Users Group that the application of criterion (c) is not contentious in respect of the DBCT, and we confirm the QCA's interpretations and approach in the QCA Draft Decision.

4.4 Criterion (d)

DBCTM's submissions on criterion (d) largely repeat points made in relation to criterion (a), which are addressed above and in the User Group submission. In particular, DBCTM repeats its claim that its Access Framework would “*preserve regulatory certainty*”, despite the absence of regulatory oversight under the framework. As explained above, DBCTM has grossly understated the benefits of declaration in providing certainty around the terms of access to DBCT and supporting efficient investment and competition in dependent markets.

Ultimately, DBCTM fails to recognise the full extent of the economic benefits delivered by declaration and effective regulatory oversight. These economic benefits are very significant, and it would be unsafe to assume they could be maintained in a world without declaration.

DBCTM also refers to the administrative and compliance costs of regulation, and the risk of “regulatory error”.

³⁰ Dalrymple Bay Coal Terminal User Group Submission in response to Queensland Competition Authority Draft Decision 11 March 2019, p 7.

³¹ *Ibid*, 8.

PN has previously noted that the costs of effective regulation are likely to be less than the cost of disputes likely to arise under DBCTM's Access Framework, and in any event these costs will be small compared to the economic benefits of effective regulatory oversight. Similarly, the cost of any "regulatory error" is likely to be small when compared to the cost of DBCTM exercising its market power in determining terms of access.

PN continues to be of the view that declaration of services at DBCT would promote the public interest.

5 Comments on the Aurizon Network submission

Declaration of access to the central Queensland coal network (**CQCN**) has manifestly delivered significant benefits. It has provided an environment in which competition can flourish in a range of dependent markets, including rail haulage markets. These benefits have been delivered through independent regulatory oversight by the QCA, controls on access prices, structural and behavioural constraints (including ring fencing constraints), and effective compliance monitoring.

Notwithstanding the constraints placed on it by declaration, Aurizon Network has shown a willingness to favour its own above rail operations in ways potentially damaging to competition. One example of this is Aurizon Network seeking to apply the electric traction tariff to competing diesel operators – although diesel operators clearly derive no value from the service, they are being forced to subsidise it.

This highlights the need to maintain effective regulatory constraints on Aurizon Network. In the absence of declaration and effective regulatory oversight, Aurizon Network would have the ability and incentive to exploit its market power in ways damaging to competition in rail haulage markets.

5.1 Aurizon Network's submissions on the declaration criteria

Aurizon Network appears to concede the declaration criteria are (or would be) satisfied, where declaration provides for access on reasonable terms.³² PN has not sought to revisit each of the criteria as we maintain they are all satisfied.

However, it argues that QCA's analysis is "incomplete" because it has not undertaken a complete assessment of "all relevant markets". Aurizon Network also claims the QCA has not fully considered the "costs of over-regulation", and whether these outweigh regulation's benefits (this issue is addressed in section 5.2 below).

Aurizon Network mischaracterises the requirements of section 87A of the QCA Act in claiming that the QCA's analysis is incomplete. This provision does not require the QCA to undertake a complete assessment of "all relevant markets" in its review of a declaration. As in any declaration inquiry, the QCA need only be satisfied that each of the declaration criteria are met. Clearly, the QCA may be so satisfied based on consideration of a limited number of relevant markets – e.g. the market in which the service is provided and one other market in which competition will be promoted.

In any event, an assessment of "all relevant markets" would not alter the conclusion the declaration criteria are all satisfied. Such further consideration would only reinforce this conclusion.

³² Aurizon Network submission, p 3.

5.2 Costs of declaration

A key theme of Aurizon Network's submissions is to complain about the costs and outcomes of recent undertaking review processes, claiming that these processes have not resulted in reasonable terms of access.

These complaints are inappropriate and irrelevant to the current declaration inquiry. To the extent Aurizon Network has concerns regarding the form of regulation, particular QCA decisions, or particular regulatory processes, these cannot be a reason to remove regulation altogether. To do so would be to throw the baby out with the bath water.

In any event, Aurizon Network's complaints regarding the current regulatory framework are misplaced. In several of the examples cited by Aurizon Network (such as the UT5 process), a key cause of additional costs and delays in decision-making has been Aurizon Network itself. If anything, these examples demonstrate the need for greater regulatory oversight, including greater use of information-gathering and coercive powers by the QCA.

Aurizon Network's calls for a more "light handed" approach is similarly misplaced. The comparison with airport regulation is inapt, in light of the very different circumstances of airports, and given growing concern (including from the ACCC) that the current light handed approach to regulation is ineffective.³³

5.3 Material impact on competition (the effect) of declaration

PN has previously noted declaration has been critical to promoting effective competition and supporting efficient investment across key freight transport supply chains over the past twenty years. The experience of PN in Queensland clearly demonstrates how regulated access to rail track has been effective in creating an environment in which rail freight competition can develop and grow. Put simply, PN's ability to grow its business in Queensland has been critically dependent on the certainty in relation to the terms of access to key infrastructure, including the CQCN.

The material benefits of competition in coal rail haulage market has included:

- significant direct investment by PN (as noted in PN's initial submission);
- increased coal volume throughput;
- increased supply chain focus to optimise annual coal volume throughput; and
- improved service quality as a result of innovation and ongoing investment by competing operators, including:
 - introduction of electronically controlled pneumatic (ECP) braking, which has delivered ongoing operational and capacity benefits for Queensland's coal transport supply chains;
 - increased locomotive power;
 - safer operation of over-length trains; and
 - innovation in the design and configuration of train consists.

By way of illustration, if it is assumed CQCN throughput increased by just 10%, as a result of competition in the coal rail haulage market and/or greater efficiency, the value of this increased throughput would be around \$3 billion per annum.

³³ ACCC, *Productivity Commission Inquiry into the Economic Regulation of Airports: ACCC submission in response to the Issues Paper*, September 2018, section 4.3.

The growth of competition in the coal rail haulage market has been dependent on structural and behavioural constraints imposed on Aurizon through declaration and regulation, not just as a result of increased transparency and accountability of rail track network access pricing. Declaration has allowed for the imposition of important structural and behavioural measures in the form of ring fencing, non-discrimination obligations, confidentiality rules, scheduling and master planning requirements.

In the absence of such constraints, a vertically-integrated rail track network provider and rail operator would have the ability and incentive to foreclose entry into the coal rail haulage market, allowing for monopoly pricing of rail transport services. Thus, the benefits of competition outlined above would be foregone. In other words, it would discourage the entry of efficient firms.

Recent experience has demonstrated the likely risks of removing declaration and allowing Aurizon to operate as an unregulated vertically integrated monopoly rail track network provider. In particular, Aurizon Network's recent behaviour demonstrates the potential risk where the monopoly rail track network provider is allowed to dictate the terms of access and / or constrain the availability of access to the network. Even with regulatory oversight and structural / behavioural constraints, Aurizon Network has sought to effectively restrict available capacity on the basis the return proposed to be allowed by the regulator is deemed unacceptable. Considering this behaviour, PN would be very concerned if declaration was removed and Aurizon was free to act in an entirely unconstrained manner.

5.4 Term of declaration

In relation to the term of declaration, Aurizon Network claims that "*the certainty benefits of a longer review period are not well established*".³⁴

PN considers the benefits of a longer declaration period are clear, in circumstances where investments required to support new entry and competition are very large, long-lived and sunk. Such investments cannot be justified unless there is long-term certainty around the framework for determining terms of access to monopoly infrastructure, and the structural and behavioural constraints that will apply to the monopoly service provider.

The key economic features of Aurizon Network and the CQCN which give rise to the need for regulation – i.e. its natural monopoly characteristics, significance to the Queensland economy, and the potential for exercise of monopoly power to damage competition in dependent markets – are unlikely to change any time in the foreseeable future. The only potential change referred to by Aurizon Network is railroad automation, but it is not clear how increased automation could alter these economic fundamentals or impact in any way on an analysis of the declaration criteria.

Given this, PN considers that a declaration period of at least 15 years is justified. Indeed, we consider that a 15 year term would be highly conservative, and the QCA could comfortably recommend declaration for at least another 20 years. This more closely aligns with Aurizon's network plan development which goes beyond 15 years.

³⁴ Aurizon Network submission, p10