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QCA Part B: Queensland Rail Declaration Review

Watco Companies LLC is one of the largest short line railroad holding companies in the US with 41 short line railroads operating on more than 5,100 miles of track, as well as 31 industrial contract switching locations. The Terminal and Port Services division currently manages more than 86 terminals, including Greens Port Industrial Complex in Harris County Texas, it is the largest private multiuser industrial park in the Gulf Coast market offering deep water and barge dock along the Huston Ship channel, with multiple operator direct Rail access across the 31 miles of rail infrastructure, four rail yards and capacity to stow 1,300 rail cars, addition to the 150 railcar mechanical repair facility. Watco's Mechanical Services operates at further 18 locations.

Watco Australia (Watco) operations commenced in 2011 after being awarded an exclusive long-term contract with CBH Group to operate its rolling stock in WA supporting its 10mt average annual export grain program at its four ports. In 2015, Watco purchased Intermodal Group, which currently handles over 20% of Fremantle Port's container freight task on rail (~150,000pa TEU containers) through direct control of the Forrestfield Intermodal Terminal and North Quay Rail Terminal.

Watco recently successfully secured a long-term contract to transport ~1mtpa bulk grain for GrainCorp in Queensland, commencing in late 2019. In looking to finalise track access arrangements, Watco has been confronted with some issues and has only just become aware that the QCA declaration review was being undertaken.

It is in relation to this contract and potential opportunities to expand operations in Queensland, that Watco provides the following submission in response to the Draft Recommendations within the QCA Part B: Queensland Rail Declaration Review, released in December 2018.

Watco apologises for the lateness of this submission and requests that the QCA Board consider this input in its deliberations.

Comments to the Draft Recommendations, QCA Part B Queensland Rail Declaration Review

1. Overview

Watco welcomes the opportunity to provide a submission in response to the Queensland Rail (QR) declaration review currently being undertaken by the Queensland Competition Authority (QCA).

Having been awarded through a competitive process the GrainCorp Queensland export rail freight services contract and recently attained accreditation from the Office of the National Rail Safety Regulator (ONRSR) to operate in Queensland, Watco is in the process of finalising its track access arrangements with Queensland Rail (QR).

As part of its tender submission to GrainCorp, Watco approached and received indicative access terms and pricing from QR. These indicative prices and terms were based on the existing QR access regulatory framework and were used by Watco in good faith to agree commercial terms with GrainCorp. These terms and pricing were used in supporting Watco's significant required investment in new rail rollingstock to provide the required rail services for the contract term.

It is only recently in looking to finalise these indicative access terms and pricing that QR have advised Watco that the track access terms and pricing is likely to change from 2020. As a result, QR have advised it can only offer a short-term contract for track access (less than 10 years) with Watco for the GrainCorp freight task.

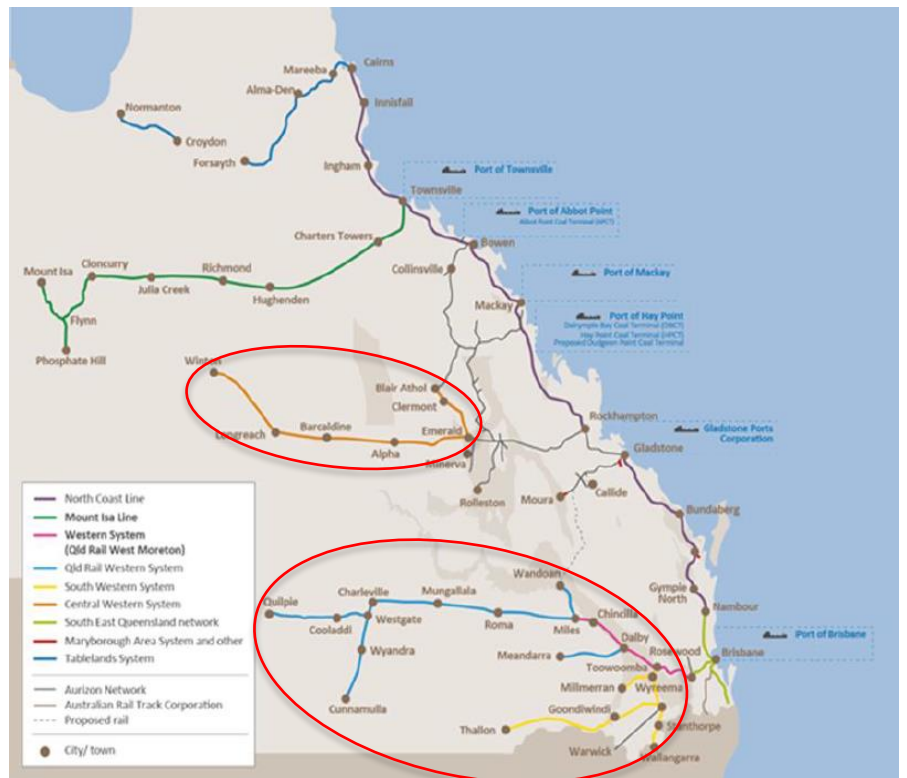
This reduced access term and the potential introduction of additional terms and future access pricing uncertainty puts at risk the significant investment Watco is making for the GrainCorp rail services contract.

The parts of the QR network where Watco is going to be directly impacted by the QCA supporting the QR recommendation to not declare are as follows:

- Central Western System;
- Western System; and
- South Western System.

These QR systems have been classified as *Other Systems Services* in the draft recommendations of the QCA Part B Queensland Rail declaration review of December 2018 and this submission will detail Watco's key concerns with the QCA findings to not declare as it relates to these specific systems.

The following Watco's submission will focus on the key areas of QR's proposed Access Framework, Access Criteria and Declaration Scope & Term.



2. QR Deed Poll and Access Framework

Watco has significant concerns with the proposed QR new access framework, which consists of:

- Draft access framework
- Draft standard access agreement; and
- Draft irrevocable deed poll.

Watco's primary concern is that it is due to commence GrainCorp operations on the identified parts of the QR network in approximately 6 months. The potential introduction and execution of a new access framework within this time frame is unrealistic and results in a high level of uncertainty for Watco as the access seeker. Alternatively, a short-term access agreement (e.g. 5 years) under the current access regime provides limited certainty and puts at risk Watco's significant investment in new rail rollingstock and facilities to support the new GrainCorp contract.

The following points detail Watco's key concerns with the proposed QR deed poll and access framework.

- If the Central Western, Western and South Western Systems are not recommended for declaration and the proposed access framework is applied, QR will have broader discretion to exercise its market power as the natural monopoly network infrastructure manager and the QCA will be unable to act as a regulator of access conditions or arbitrator of access disputes.
- QR has a wide scope to amend the terms of the access framework within the contract term and this latitude does not provide the required regulatory certainty and undermines incentives for rail operators to invest capital.
- QR would have the ability to price up to what the market could bear, without appropriate protections for reasonable and fair terms of access. In addition, the proposed access framework provides no guarantee that the service provided by QR (including reliability and performance) would correspond with any pricing mechanism. Our experience with CBH in Western Australia where "what the market can bear" principles were used has led to significant closures of regional railway lines. These lines were considered by Watco as safe and profitable; but economic theory was applied, including 'hub and spoke' principles of roading to the nearest railhead with the principle of consolidation to create economic scale. Unfortunately, once the task has transferred from rail to road it tends to stay on that mode. This grain freight now arrives at the Kwinana Port via the metropolitan road network in Perth.
- The term of the proposed deed poll is limited to 5 years and the access framework is limited to 10 years, with no certainty as to how the terms of access will continue beyond that point.
- The only option available to access holders to challenge QR amendments to the access framework is to commence legal proceedings, which are cost and time prohibitive and generally ineffective (as experienced in the ongoing grain rail freight network access dispute in Western Australia between the track provider and access seeker). Watco understands the QCA is empowered to determine access disputes, which creates more certainty around how issues in dispute are considered and assessed. The QCA is seen as being transparent and rigorous in its approach to access matters and has a track record in dealing with such matters.

In summary, Watco supports the following statement in the QCA December 2018 report and recommends this be applied to the Central Western, Western and South Western Systems.

Given the proposed access framework is unexecuted and there are considerable uncertainties in how it would apply, the QCA does not consider the proposed access framework can be considered as an appropriate set of arrangements in the assessment of the state of the market in a future without declaration. As such, the QCA has not considered Queensland Rail's proposed access framework any further at this stage.

3. Access Criteria

a. *Competition*

With respect to *Criterion (a) Promote a material increase in competition*, Watco does not support QR's position that access as a result of declaration would not promote a material increase in competition and that none of the services on the Central Western, Western and South Western systems satisfy Criterion (a), as QR does not have the ability or incentive to exercise market power to adversely affect competition.

The following points support Watco's position that competition is and will continue to be promoted on the three systems if these systems are declared.

- Declaration provides for transparency and certainty of the terms of access, which promotes rail freight competitiveness compared with road freight. Removal of declaration would compromise the competitiveness of rail freight services as it would remove regulatory certainty which ensures rail remains competitive with road in servicing grain and other regional freight tasks on these three rail systems.
- Declaration promotes long term access certainty on fair and reasonable terms, a right to have QCA arbitrate access disputes, efficient access pricing and the potential to have reference tariffs, which all promote competition in dependant markets, particularly in regional Queensland agricultural freight markets and above rail operations.
- Watco and GrainCorp's rail haulage contract due to commence in late 2019 is evidence that competition in above rail operations has been achieved within the current declared framework for these three systems. The ability to achieve competition in above rail services, including the significant investment and innovation that will result, is at risk if the three systems are not re-declared.
- Watco's entry into the Queensland above rail market is predicated on its proposed significant investment in new above rail rollingstock, which given the potential change in access arrangements and subsequent impact on investment risk profile, has the potential to seriously alter service provision. As a new entrant into the Queensland above rail market, Watco is having to incur significant sunk costs through investing in long-life rollingstock assets (with a typical 25 year+ life) as well as the associated maintenance and provisioning facilities. Given the specific operational characteristics of the Central Western, Western and South Western systems, such as a narrow-gauge track with specific tonnage allowances, such assets are unable to be readily switched to alternative uses elsewhere.

- Proposed introduction of supply chain efficiencies to attract more grain freight from road to rail will be seriously impacted with the uncertainty of access arrangements.
- The successful introduction of Watco as a new above rail operator in the Central Western, Western and South Western systems supports the National Competition Council's position with regards to competition.
- On the basis of the current track access regulatory regime, Watco has witnessed the success of above rail competition in Queensland and the positive impact this has had for freight customers, the economy and the broader community. The ability for new above rail entrant like Watco to enter the Queensland market is critically dependant on the stable operation of Queensland's regulatory framework under Part 5 of the QCA Act.

In summary, Watco supports the following statements in the QCA December 2018 report with respect to the competition access criteria on other QR systems and recommends this be applied to the Central Western, Western and South Western Systems.

The QCA considers that a future with declaration will continue to provide for access to the rail network on reasonable terms and conditions due to on-going regulatory oversight. The protections provided by the regulatory framework will provide certainty to a potential new market entrant (or renewing access holder) about the likely future terms and conditions of access, reducing the risks of undertaking market entry and operations. The certainty provided by access under declaration, including at time of contract renewal, is likely to be a critical factor in supporting efficient entry to and efficient participation in the above-rail haulage market, thereby materially promoting competition.

Watco submits that the QCA position at chapter 3.10 of the December 2018 Draft Recommendations report was made in the absence of the number of points raised in this submission and should be amended to conclude that each of the services provided on the Central Western, Western and South Western systems do satisfy Criterion (a).

b. Demand

In relation to the Central Western, Western and South Western systems, Watco supports the December 2018 QCA draft recommendation that *Criterion (b) Meet total foreseeable demand at least cost*, has been satisfied and that this supports the continued declaration of these three QR systems.

c. State Significance

In relation to the Central Western, Western and South Western systems, Watco supports the December 2018 QCA draft recommendation that *Criterion (c) State significance*, having regard to the size of each of the three systems, has been satisfied and that this supports the continued declaration of these three QR systems.

However, Watco does not agree with the QCA's position that the Central Western, Western and South Western systems are not significant, when regard is had to each system's importance to the Queensland economy. Whilst these systems do not transport large volumes of bulk freight or carry general freight between major urban centres, these rail systems do provide key transport links accessing regional Queensland agricultural markets and communities. These agricultural markets like grain, hay, livestock etc are the backbone of

these regional economies and require support in the form of accessible and competitive transport networks and services. Re-declaring these three rail systems by QCA confirms that level of support.

d. Public Interest

With respect to *Criterion (d) Public interest*, Watco does not support QR's position that access as a result of declaration would not be in the public interest and that none of the services on the Central Western, Western and South Western systems satisfy Criterion (d).

The following points support Watco's position that the public interest is and will continue to be supported on the three systems if these systems are declared.

- Declaration of the Central Western, Western and South Western systems would promote the public interest by providing long term certainty as to rights of access, access being available on reasonable terms and thereby facilitating investment in the Central, Western and South West regions, with wider flow-on economic benefits through employment, royalties to the State and regional economic growth.
- Declaration of the QR systems has supported significant investment and competitive entry in dependant markets. Watco's entry into the grain freight market on the Central Western, Western and South Western systems in late 2019 and significant investment in rollingstock and facilities will be in the broader public's interest.
- Public benefits from investment and provision of rail transport services include known factors that road freight produces 14 times greater accident costs and 16 times as much carbon pollution than rail freight per tonne kilometre.
- Rail operators and customers bear their own costs of the regulatory process and the prudent expenditure by QR on the regulatory process which is taken into account in the prices set by the QCA. As Watco are supportive of declaration continuing, it must be that the reasonable terms and conditions of access arising from declaration promote the public interest. Watco considers that the costs of QCA administering the regulatory regime applicable to declared systems are small compared to the considerable benefits of declaration.
- In addition to the soon to commence GrainCorp bulk grain freight contract, Watco is actively investigating other rail freight opportunities in central and south western Queensland. In its recent engagements with various government agencies, local shires and freight customers, Watco has been surprised with the resurgent interest in shifting freight from road to rail and identifying investment and innovation opportunities to enable this to occur. Watco's corporate history of similar investments in Western Australia and in North America support these potential opportunities in Queensland, with stable track access arrangements one of the keys to its success.

Watco submits that the QCA position at chapter 5.8 of the December 2018 Draft Recommendations report was made in the absence of the number of points raised in this submission and should be amended to conclude that each of the services provided on the Central Western, Western and South Western systems do satisfy Criterion (d).

4. Declaration Scope & Term

Watco agrees with the QCA that a term of 15 years would be appropriate and that the fundamental economic features of QR's network, in particular its natural monopoly characteristics, significant investment required to participate and its significance to the Queensland economy and public interest, will not change for at least the next 15 years.

Watco therefore supports the QCA's draft recommendation for a 15 year declaration term for the North Coast, Mount Isa, West Moreton and Metropolitan systems and requests that the same declaration term be applied to the Central Western, Western and South Western systems.

Watco has not provided any specific feedback regarding the QR Tablelands system but is confident that a similar rationale applies to this system as to the feedback provided in this submission to the need to re-declare the Central Western, Western and South Western systems.

5. Summary

Rail is a critical link in regional agricultural export supply chains and it must perform efficiently to enable Queensland businesses to compete on the world stage sustainably. This will only come with confidence to make smart investments, a strong, stable regulatory environment and having the security to commit to capital intensive projects that will allow the benefits to flow to those who hold the risks.

Watco firmly believes any move to not declare the QR Central Western, Western and South Western systems will result in harming the attractiveness of rail and drive significant volumes of regional freight to the already strained road network, resulting in increased road safety, community and environmental impacts that will last for decades to come.

Yours sincerely



Ken Potts
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Watco Australia