Submission to the Queensland Competition Authority in response to the Draft Decision of 18 December 2018

11 March 2019

## Contents

## 1 Executive Summary

New Hope Corporation Limited and Yancoal Australia Limited (the ***South West Producers***) welcome the opportunity to provide submissions to the Queensland Competition Authority (***QCA***) on the Draft Decision of 18 December 2018 (the ***QCA Draft Decision***) to declare the West Moreton and Metropolitan system service under Part 5 of the *Queensland Competition Authority Act 1997* (Qld) (the ***QCA Act***).

The South West Producers strongly support:

(a) the QCA's conclusion that each of the access criteria are satisfied in respect of the West Moreton and Metropolitan system service; and

(b) the recommendation that this part of the existing QR service be declared for 15 years.

## 2 Declaration of services that form part of a declared service

As discussed in the South West Producers previous submissions, section 87A of the QCA Act empowers the QCA to recommend that a part of a declared service, that is itself a service, be declared (where the access criteria are satisfied in respect of that part).

In that regard, the South West Producers agree with the QCA[1] that, given the language of s 87A QCA Act, it is appropriate to:

(a) first assess whether the service as a whole (i.e. the service as described in section 250 of the QCA Act) meets the access criteria; and

(b) where evidence arises that demonstrates that any part of the service, that is itself a service, has characteristics which require different or further consideration, to assess whether that individual part of the service meets the access criteria.

The second limb of that approach, gives rise to the question as to how to assess the 'part of the service' utilised by the South West Producers and other rail customers which utilise access from origins on the West Moreton system.

In that regard, the South West Producers agree with the QCA[2] that, given the commercial reality that the West Moreton system is not used by itself, but for access from West Moreton origins to the Port of Brisbane (or Metropolitan Brisbane stations for West Moreton passenger services), that where parts of a service are to be considered individually, the two systems are appropriate to be considered together as a single service. That follows because access to the West Moreton system alone is clearly not itself a usable service (and therefore concepts like demand for the service which are relevant to the access criteria only make sense where access to the West Moreton and Metropolitan systems are treated as a single service).

The South West Producers acknowledge the QCA's draft findings that the current QR declared service, considered as a whole, does not satisfy all of the access criteria. Consequently, the South West Producers have focused their submissions principally on the service provided by the West Moreton and Metropolitan systems.

[1] QCA Draft Decision, Part B, page 4.
[2] QCA Draft Decision, Part B, pages 61-62.

## 3 Criterion (b) – meeting foreseeable demand at the least cost

The South West Producers agree with the QCA's approach to the interpretation of criterion (b) and the steps involved in determining whether criterion (b) is satisfied.[3]

### 3.1 The service and facility

The first two of those steps are defining the relevant service and the relevant facility,

Consistent with the approach discussed in section 2 of these submissions above:

(a) the relevant service is either:

  (i) the entirety of the QR declared service as defined in section 250 of the QCA Act – namely the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating a railway for which QR (or a successor, assign or subsidiary) is the railway manager; or

  (ii) the West Moreton and Metropolitan system rail access service; and

(b) the relevant facility is the rail infrastructure corresponding to those alternative service definitions, being either:

  (i) the entirety of the QR network; or

  (ii) the rail transport infrastructure constituting the West Moreton system and at least those parts of the Metropolitan system required to provide access for West Moreton services to the Port of Brisbane.

### 3.2 The market

The South West Producers strongly support the QCA's conclusion that there are no substitutes for rail haulage in respect of bulk goods (including coal) such that the market is confined to rail infrastructure access (that is, the market for below-rail services).

As the QCA notes:[4]

(a) bulk goods (such as coal) cannot be economically transported by road due to the inherent cost advantage of rail for bulk goods through economies of scale, except for transport over very short distances; and

(b) the cost differences mean that switching between rail and road haulage would not occur in response to a small but significant non-transitory increase in price (***SSNIP***) of the below rail services.

In addition, the South West Producers continue to note the existence of substantial non-cost barriers (as noted in their previous submissions), which would prevent substitution irrespective of the economic viability, namely that:

(a) Queensland Bulk Holding's leasing arrangements for their Port of Brisbane coal terminal would require consent from the Port of Brisbane Limited for transport by road (which the South West Producers do not believe would be forthcoming); and

(b) Environmental, community and social licence to operate factors make trucking large quantities of coal through metropolitan Brisbane unpalatable in any case.

[3] QCA Draft Decision, pages 8-18.
[4] QCA Draft Decision, Part B, pages 15-16.

### 3.3 The period for assessing total foreseeable demand

The South West Producers strongly support the QCA's conclusion that the period for assessing total foreseeable demand in the West Moreton and Metropolitan systems services (and ultimately, the period for which those services should be declared) is 15 years.[5]

That period represents an appropriate balance between providing long term certainty to users of the service and the period for which the QCA can have confidence that the access criteria will be satisfied.

It is relevant to determining the appropriate period to note that both South West Producers have investment decisions in relation to West Moreton system mines (a potential expansion of Cameby Downs production for Yancoal and the potential development of New Acland stage 3 for New Hope). In addition, Aurizon, the incumbent provider of haulage services will soon need to make investment decisions in relation to the rolling stock employed for coal haulage on the network which the South West Producers understand are nearing the end of their useful life.

The investments in mines and new rail rolling stock are long term (20 year or more) investments involving high up-front capital costs. In other words, for all parties utilising the West Moreton and Metropolitan rail access service, long term certainty is critically important for the investment decisions that will come under consideration in the near future.

While the South West Producers acknowledge that certainty of demand forecasts and changes in market conditions are relevant factors, the only change which has been raised which might alter the analysis appears to be the potential development of Inland Rail in a way that it becomes an alternative method of coal transportation for the South West Producers. However, the South West Producers agree with the QCA that there are substantial uncertainties in relation to Inland Rail,[6] including:

(a) whether the rail alignment or its operational characteristics will be such that it would ever provide an alternative to the South West Producers or other West Moreton network rail users; and

(b) the timing for its development,

such that it is not appropriate to shorten the period of declaration based on speculation about the timing and impact Inland Rail might have.

Even if Inland Rail was developed in a manner that provided a theoretical alternative for transport of West Moreton coal or other freight, given the significant cost of developing the Inland Rail project and the predominant purpose for its development being provision of unrelated services, there is a high degree of uncertainty as to whether pricing for access would be set in a manner that would make West Moreton coal transport economically viable.

As the QCA notes, QR has the right seek to seek revocation if it considers the access criteria are no longer satisfied at some point in the future before the declaration would otherwise have expired, such that the declaration period should not be shortened based on mere speculation about future changes.

### 3.4 Do the West Moreton and Metropolitan systems meet foreseeable demand at least cost

To the best of the South West Producers' knowledge, the QCA's conclusions that each of QR's rail systems are currently operating below capacity, have historically operated at below capacity and that there is no credible data to suggest total foreseeable demand over the 15 year

[5] QCA Draft Decision, Part B, page 20.
[6] QCA Draft Decision, Part B, page 21.

recommended declaration period would at any time exceed the existing capacity on the relevant rail system, are correct.[7]

In respect of the West Moreton and Metropolitan systems, those findings are consistent with the South West Producers attempts to provide more precise forecasts of demand[8], QR's own submissions in this declaration review process that the West Moreton system is among those with 'high under utilisation rates',[9] and the fact the systems previously provided services in respect of the former Wilkie Creek mine (but no longer do so following that mine's closure in 2013).

The South West Producers also note the submissions made by QR with its 2020 draft access undertaking in August 2018 – which contemplated both a high tonnage (9.1 mtpa) and low tonnage (2.1 mtpa) scenario, suggesting the potential for further declining demand. Even on the high tonnage scenario, it is clear that demand that could be accommodated by the existing network, which is understood to have a capacity of approximately 10.8 mtpa.[10]

Given the likely demand outlook (even at its highest) is less than the QR network's existing capacity and that there is no existing alternative facility which could provide the service, it is beyond doubt that the costs of providing the below rail service will be less using the West Moreton and Metropolitan network than it would be utilising two or more facilities.

As recognised by the QCA,[11] the alternative of utilising two or more facilities would necessarily involve all of the existing largely fixed costs of operating the QR network, in addition to incurring extremely high capital costs for developing a second new railway, including the costs of land acquisition, planning, design, development and construction.

When the conclusion on criterion (b) is so abundantly clear, the South West Producers consider it is appropriate for the QCA to be satisfied that foreseeable demand can be met at least cost by the QR network rather than any two or more facilities (without it being necessary for the QCA to make more precise finding as to the likely foreseeable demand).

### 3.5 Conclusion

Accordingly, the South West Producers consider it is absolutely clear that the West Moreton and Metropolitan systems services are able to meet total foreseeable demand throughout the proposed 15 year declaration period at the least cost compared to any two or more facilities, such that criterion (b) is satisfied.

[7] QCA Draft Decision, Part B, page 22.
[8] South West Producers Initial Submission, [7.5].
[9] Queensland Rail Initial Submission, page. 6.
[10] Bureau of Transport and Regional Economics, *Freightline 4 – Australian coal freight transport*, 2016, at 14 (as referenced in the QCA Draft Decision, Part B, page 65).
[11] QCA Draft Decision, Part B, page 23.

## 4 Criterion (a) – promote a material increase in competition

### 4.1 West Moreton and Metropolitan system

The South West Producers acknowledge the QCA's view that it cannot be satisfied that criterion (a) is met in respect of the QR network (as a whole) given the nature of competition in dependent markets is highly disparate such that analysis of the network as a single service is not possible.[12]

Adopting the approach discussed in the QCA Draft Decision and section 2 of these submissions, the question then becomes whether criterion (a) is satisfied in respect of the service provided by the West Moreton and Metropolitan systems.

For the reasons set out in section 4 of these submissions, the South West Producers strongly support the QCA's conclusion that access to the West Moreton and Metropolitan systems services (together) on reasonable terms and conditions as a result of declaration would promote a material increase in competition in at least the West Moreton region coal tenements market (and is likely to do so in both the West Moreton coal rail haulage market and the Port of Brisbane coal handling services market as well).

### 4.2 Promotion of material increase in competition

Consistent with their previous submissions on this issue, the South West Producers strongly support the QCA's finding[13] that the promotion of a material increase in competition (in a dependent market) is concerned with the *'improvement in the opportunities and environment for competition such that competitive outcomes are materially more likely to occur'*.

That is reflective of the approach adopted by the National Competition Council (***NCC***) (both in its Guide to Declaration[14] and its Preliminary Statement of Reasons in respect of the Port of Newcastle shipping channel service revocation application[15]) (the ***Shipping Channel Reasons***) and the Australian Competition Tribunal in its Sydney Airport decision.[16]

It logically follows from that interpretation that the QCA must be correct, that criterion (a) is concerned with the possibility that more efficient firms would enter a dependent market in a future with declaration, rather than focusing on the number of competitors or potential entrants.[17]

That position is also consistent with the NCC's statement in the Shipping Channel Reasons that:[18]

*when making judgements about likely future conditions and the environment for competition it is necessary to look beyond short-term static effects. In particular, it is appropriate to consider the effects of declaration on investment incentives in dependent markets*

It is clear from the analysis above in relation to criterion (b) that there are no substitutes for the West Moreton and Metropolitan rail access service, such that QR occupies a bottleneck monopoly position and clearly holds market power.

The question is therefore how QR's likely future conduct would be affected by declaration or the lack of declaration – considering any applicable constraints and incentives it would face in those two alternate future scenarios.

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[12] QCA Draft Decision, Part B, page 27.
[13] QCA Draft Decision, Part B, page 27.
[14] NCC, *Declaration of Services, A guide to declaration under Part IIIA of the Competition and Consumer Act*.
2010 (Cth), April 2018 (the NCC Guide to Declaration), page 32.
[15] NCC, Revocation of the declaration of the shipping channel service at the Port of Newcastle, Statement of Preliminary Views, 19 December 2018 (NCC Draft Revocation Decision) at [6.51].
[16] Re Virgin Blue Airlines Pty Limited [2005] ACompT 5 at [146].
[17] QCA Draft Decision, page 21.
[18] NCC, Draft Revocation Decision at [5.7].

## 4.3 The proposed access framework does not provide any constraints on QR

### (a) The access framework does not form part of an appropriate counterfactual

The South West Producers share the QCA's view[19] that QR's proposed access framework is not an appropriate alternative scenario on which to base the assessment of the likely state of dependent markets in a future without declaration.

In particular, the South West Producers agree that:

- (i) the access framework and related deed poll has been provided as a draft (as recognised in QR's covering letter of 18 June 2018 under which it was submitted to the QCA and evident from the draft watermark) and there is no certainty it would be executed or given effect to at all, or in that form; and
- (ii) there are significant uncertainties about how it would apply in any case, particularly given the extensive ability QR has to amend the framework in any way that is 'not inconsistent with the framework's objective'.

The South West Producers also take this opportunity to reinforce their continuing concerns with the inappropriateness of QR's attempt to manipulate the outcome of this regulatory decision-making process by engineering an artificial counterfactual. In that regard, the South West Producers note that this is a very different circumstance to that where an undeclared service has past evidence from which it might be judged how future access in the absence of declaration would be provided – but rather a new hypothetical with no evidence of ever having been implemented.

### (b) QR's power to make amendments makes the future application of the access framework completely uncertain

In relation to QR's powers to make amendments, the QCA is clearly right (consistent with the South West Producer's previous submissions) that where an access seeker's or holder's only rights are to dispute such amendments (with no right to damages), through costly litigation, and the only criteria is that the amendments need to satisfy to be upheld in any such dispute is that they are to not be inconsistent with objectives of a high level nature – that the theoretical potential for court review of any proposed amendments will not provide any effective constraint on the types of amendments that QR could make in the future.[20]

It is important to note that the Court's task in assessing whether an amendment was 'not inconsistent' with the object would be in stark contrast to the QCA's task when assessing amendments to an approved access undertaking where it would have regard to a similar object but only be required to approve the amendments if it considered doing so appropriate (as per section 138 of the QCA Act). To put it bluntly, it will clearly be possible for QR to make amendments that would not be accepted as appropriate if QR sought to make the same amendments under its access undertaking while declared.

Consequently, it is clear that such a dispute mechanism will provide no real constraint on QR's ability to amend the access framework in the future, and therefore whatever the terms of the access framework, they should not be taken into account in assessing the likely future state of the market without declaration.

[19] QCA Draft Decision, Part B, pages 29-30.
[20] QCA Draft Decision, Part B, page 31.

## 4.4 The future with declaration – the constraints declaration imposes

The South West Producers strongly support the view that a third party access regime under Part 5 of the QCA Act would, in a future with declaration, provide a credible constraint on QR's use of market power.[21]

**Constraints imposed by declaration**

That is consistent with each of the protections the existing declaration currently provides as set out in the South West Producer's previous submissions and accepted as accurate by the QCA,[22] namely:

*(a)* *the QCA is responsible for setting Western system coal reference tariffs and has a clearly established methodology for setting those tariffs at an efficient level …*

*(b)* *the QCA is responsible for setting reasonable standard terms of access – as per the standard access agreement terms;*

*(c)* *a transparent queuing process which provides an even playing field for all access seekers;*

*(d)* *a more transparent operating regime – including through the operating requirements manual*

*(e)* *the disclosure and reporting regime – which provides transparency and accountability and should assist in improving performance and informing access negotiations*

*(f)* *the QCA Act and undertaking provides rights to bring access disputes where an access seeker cannot reach agreement with QR on obtaining access to the QR Network*

*(g)* *other protections that the QCA Act provides for declared services generally, such as obligations to:*

  *(i)* *negotiate access requests in good faith*

  *(ii)* *try to meet the reasonable requirements of users*

  *(iii)* *the prohibition against preventing or hindering access or use of the services.*

In particular, it is absolutely clear that the QCA approved reference tariffs and standard access terms prevent QR unilaterally setting the terms of access and, combined with the queuing regime, prevent capacity being auctioned based on a willingness to pay.

**Past evidence that declaration constrains monopoly pricing**

While the QCA is clearly right that criterion (a) requires a comparison of the likely future state of dependent markets with and without declaration – where a declaration currently exists, the likely state of such a future can be informed by the evidence and behaviours of the past.

In that regard, the South West Producers note the significant differences in price alone that have resulted from the QCA setting reference tariffs in QR's undertaking processes rather than QR being permitted to set charges at prices it determined appropriate:

| **Access Undertaking Process** | **Initial Tariff Claim** | **Ultimate QCA Approved Tariff** |
|---|---|---|
| Queensland Rail[23] 2005 Draft Access Undertaking | \$12.48-\$13.19/'000gtk | \$8.50/'000gtk |

[21] QCA Draft Decision, Part B, page 33
[22] QCA Draft Decision, Part B, pages 32-33.
[23] Note: this entity was subsequently privatised and became Aurizon Network.

| | | |
|---|---|---|
| Queensland Rail 2015 Draft Access Undertaking | $19.41/'000gtk (escalated to $19.74/'000gtk by the time of the QCA decision on the 2016 Access Undertaking) | $17.92/000gtk West Moreton<br>$16.66/000gtk Metropolitan |

The QCA's final decisions on these processes indicate that the claims submitted under these processes exceeded reasonable allowances by:

- 32-36% for the 2005 DAU
- 7.6% (West Moreton) and 14% (Metropolitan) for the 2015 DAU.

QR also sought, during the "AU1" process, to retain around $35m of excess revenue collected over the period during which 'transitional' tariffs applied. The QCA rejected this approach and required QR to return this amount in the form of 'adjustment amounts'.

It should be noted that the pricing that QR initially sought in those processes is likely to be well below the price it would seek in the absence of declaration, as it would clearly be anticipated that QR would feel more constrained in the pricing proposed in the context of such a regulatory process than it would in the complete absence of declaration.

**Outcomes of declaration**

Consequently, the South West Producers agree with the QCA's summary[24] that the QCA Act access regime arising from declaration prevents QR from unilaterally setting the terms on which it would negotiate access and the terms of access themselves, and as a result provides for

(a) predictability in approach and regulatory certainty – the process to set access terms (e.g. access charges) is transparent, consultative and follows established methodologies;

(b) transparency – as the terms of the access undertaking and related documents are publicly available at the process of setting and reviewing these terms is transparent;

(c) equal rights – as the rights and remedies available under the QCA Act are available equally to all access seekers; and

(d) enforceability – the standard terms set by the QCA in an approved access undertaking, as well as the QCA's access determinations, are court enforceable; any access seeker or holder can bring a dispute to the QCA or the courts and be assured that a transparent dispute resolution process will be followed.

## 4.5 The future without declaration – a lack of constraints

The South West Producers agree with the QCA's assessment[25] that to determine the likely state of dependent markets without declaration, the QCA must focus on assessing how QR, as a monopolist, might behave in such a market where there are no regulatory or contractual constraints on its behaviour.

### (a) A lack of other constraints

In that regard, the QCA is clearly correct that QR has an incentive to maximise profits – and that maximising profit is not the same as maximising demand.[26]

The South West Producers strongly agree with the QCA's assessment[27] that:

[24] QCA Draft Decision, Part B, page 34.
[25] QCA Draft Decision, Part B, page 34.
[26] QCA Draft Decision, Part B, page 46.
[27] QCA Draft Decision, Part B, pages 51-53.

(i) there is no information to suggest that QR's position as a statutory authority and its obligations under the transport services contract would ensure QR provided access on reasonable terms and conditions (at least in relation to West Moreton coal users);

(ii) the fact that dependent markets may currently be workably competitive does not prevent a finding that criterion (a) is satisfied – rather it may (and the South West Producers consider, is) attributable to the fact that QR's below rail access services have been declared for approximately 20 years prior to the review;

(iii) the threat of future declaration would not provide a sufficient constraint (particularly where the QCA had, in this hypothetical scenario, determined during the review that, despite QR having no effective constraints, the service should not be declared applying the very same declaration criteria which would apply in any future application for declaration);

(iv) the general competition law prohibition on misuse of market power would not provide a sufficient constraint – as even where the prohibition was breached (the scope of which is fairly uncertain given the recent amendments to the prohibition) it does not provide a way of setting terms of access, and would not prevent material damage being done to competition by monopoly behaviour before any appropriate enforcement action could be ordered by a court under that prohibition in any case.

(b) **How may unconstrained monopoly pricing impact on competition?**

Once it is accepted that in a future without declaration QR will have an ability to exercise its monopoly power in order to maximise profits, the next step is determining how that monopoly pricing could impact on competition.

The critical issue – as the QCA rightly identifies,[28] is the material uncertainties and potential for monopoly pricing, that market participants will face at the time of contract renewal.

As the QCA notes, this is not just a mere transfer of rents or value between market participants with no impact on competition.

Rather, as is evident from the submissions made by both the South West Producers and Aurizon Coal, coal producers and above rail operators can clearly foresee the risk that sunk investments they make will be exposed to the risk of expropriation of monopoly profits by QR at the time of contract renewal (even if QR might be argued to be initially incentivised to set prices in a way that encourages initial contracting to take up surplus capacity).

This creates the two period hold up problem identified by the QCA (and discussed in more detail below in the context of the impact it will have on the relevant dependent markets).

The South West Producers agree with the QCA's view that this risk is sufficiently material that a potential more efficient entrant will likely be deterred from entering the market in the first place, and that existing interests will be deterred from making future efficient investments.

## 4.6 Identifying the dependent markets

(a) **QCA's identification of dependent markets**

The South West Producers are willing to accept the QCA's assessment of the relevant dependent markets as including:

(i) the West Moreton region coal tenements market;

[28] QCA Draft Decision, Part B, page 47.

(ii) the above rail haulage market on the West Moreton system; and

(iii) the Port of Brisbane coal handling services market.

The only difference between the QCA's proposed market definitions and those initially proposed by the South West Producers is the theoretical differences between a 'Port of Brisbane catchment' coal tenement and a 'West Moreton region' coal tenement.

In that regard, the South West Producers accept as appropriate the QCA's reasoning that, as the analysis relates to access to the West Moreton (and Metropolitan) system service – the geographic dimension of the market should be limited to tenements which use, or can be expected to use, the West Moreton (and Metropolitan) system.[29]

(b) **Reasons for the geographic dimensions of the dependent markets**

The geographic scope of the markets is clear and a feature resulting from:

(i) the unique rail infrastructure constraints applicable to the West Moreton and Metropolitan rail systems (lower axle loads and smaller passing loops resulting in significantly lower payload rolling stock relative to other coal systems, reserved paths for non-coal services and passenger priority);

(ii) the significantly different infrastructure costs per tonne;

(iii) lack of connections to other coal rail systems or coal terminals;

(iv) the vessel constraints at the Port of Brisbane; and

(v) coal quality differences – with the thermal coals produced by the mines in this region being 'harder' than most other coals,

creating separate markets relating to the West Moreton region and services that are only provided to West Moreton producers.

(c) **Support for a tenements market**

Beyond the geographic dimension of the markets, the other aspects of the market definition should be uncontentious.

Tenements markets separate from end product markets have been found to exist by the Australian Competition Tribunal (in relation to the Pilbara rail access proceedings), the NCC (in relation to the Newcastle shipping channel) and the QCA itself (in the other declaration review decisions). Those findings are made based on differences in the participants and competitive dynamics in the market – a position that is reflected here, where the West Moreton coal production of the South West Producers is sold in global thermal coal markets, but the competition for coal tenements in the West Moreton region is much narrower.

While it is not critical to the findings under criterion (a) in respect of this service, the South West Producers also note it is possible, if not likely, that the tenements market is in fact two separate markets – one in respect of exploration and development tenements and one in respect of mining tenements, given the differences between the risk profile and valuation of such tenements resulting in them not being close substitutes. In that regard, the South West Producers note the QCA's reasoning and report from Balance Advisory in respect of the Dalrymple Bay Coal Terminal coal handling service that came to that view.[30]

## 4.7 West Moreton region coal tenements market

(a) **The importance of infrastructure costs to entry into the market**

[29] QCA Draft Decision, Part B, page 63.
[30] QCA Draft Decision, Part C and related Balance Advisory Report – DBCT Criterion (a).

The South West Producers agree with the QCA's findings[31] (consistent with the South West Producers' previous submissions) that:

(i) the decision of a buyer to enter the West Moreton regional coal tenements market is heavily dependent on their valuation modelling for the tenement;

(ii) the valuation method used to determine the viability of entry to a coal tenements market as described in the South West Producers' initial submission (including infrastructure/logistics costs being a critical part of such financial modelling), is consistent with market practice; and

(iii) infrastructure and logistics costs are likely to be a material consideration in the overall decision-making process for a potential market participant – given the unique infrastructure constraints (and therefore higher supply chain costs relative to those in other coal supply chains) faced by West Moreton coal producers.

The South West Producers both confirm that the conclusions reflect the reality of their evaluation and decision making processes - with infrastructure cost considerations being critically important to future investment decisions under consideration in respect of New Acland and Cameby Downs.

(b) **Competition in the West Moreton region coal tenements market with declaration**

The analysis in sections 4.4 and 4.5 above apply to the West Moreton region coal tenement market.

That is, with declaration:

(i) QR will be required to continue to provide for access to the below rail service on the West Moreton and Metropolitan systems on reasonable terms and conditions due to ongoing regulatory oversight and the protections provided by the QCA access regime (including reference tariffs, standard access agreement terms and the QCA arbitration of access disputes); and

(ii) those protections will provide long term certainty to a potential new entrant about the future terms and conditions of access – reducing the risks associated with entry into the West Moreton region coal tenements market.

and without declaration QR has the market power (ability) and profit maximising incentive, and no applicable restraints, to increase prices for the service in a manner that will have a material adverse impact on competition in the tenements market for the reasons set out below.

Given that coal miners in the West Moreton region are entirely dependent on the use of rail haulage to transport coal (see the analysis in respect of criterion (b) above), the QCA is correct that the certainty provided by access under declaration, including access at an efficient price and on reasonable terms and conditions, will be a critical factor in promoting future efficient entry into and operations in the West Moreton regional coal tenements market.

(c) **Competition in the West Moreton regional coal tenements market without declaration**

As discussed in detail in respect of criterion (b) above, and as accepted by the QCA,[32] road haulage does not provide an effective constraint on the terms QR could offer in the absence of declaration due to

(i) The significant price constraints for haulage of bulk products including coal; and

[31] QCA Draft Decision, Part B, page 63.
[32] QCA Draft Decision, Part B, page 66.

(ii) The unique non-price constraints on utilising road haulage to transport coal to the Port of Brisbane (Port of Brisbane leasing arrangements government policy, environmental, safety and social licence to operate issues arising from transport through the Metropolitan region).

There are therefore no alternative options available for West Moreton below rail access customers, such that there are no constraints imposed on QR by competitors or customers.

In circumstances where it is clear that QR is not competitively constrained, and in the absence of declaration does not face regulatory constraints, and QR is otherwise motivated by commercial profit maximising incentives, it is clear that QR would have both the incentive and ability to exercise its market power in the absence of declaration.

The clearest way that would impact on competition in the tenements market is through the economic hold-up problem identified by the QCA, discussed in more detail below.

## 4.8 The two-period hold-up problem – why criterion (a) is clearly satisfied

The South West Producers strongly support the QCA's analysis and conclusions regarding the 'two-period hold-up problem'.

The nature of mining investments being very long-term (typically 10 to 30 years) in length and the comparatively short-term nature of below-rail access agreements (typically 10 years) and existing capacity on the system could be argued to incentivise QR to provide access to a new entrant on reasonable terms at the outset of a period without declaration (the first period) in order to attract utilisation of existing capacity.

However, once that volume is attracted onto the system, QR's incentives would completely change at the point of the next contract renewal.

As discussed above, in the absence of declaration, there are no effective constraints on QR's behaviour, so the question is solely one of the economic incentives QR and the user would face at that point.

Without declaration at the time of contract renewal, an access holder would have no certainty as to the price which would be charged – given the absence of any reference tariff or regulator to arbitrate an appropriate access price.

QR would therefore be incentivised to raise the price to the point just below the point at which the producer would cease railing (i.e. the price at which the producer would cover its variable costs).

This issue cannot be resolved by entering a life of mine rail access contract – due to the extreme difficulty of estimating in advance the exact life of a mine, and the serious exposure to take or pay obligations that would create for a coal producer where a mine become uneconomic in a shorter than anticipated period (for example due to changes in coal prices or natural disasters).

As already discussed in section 4.5 of these submissions, this is not just a mere transfer of rents or value between market participants with no impact on competition, because the potential purchaser of a coal tenement in the West Moreton region can clearly foresee the risk that sunk investments they make will be exposed to the risk of expropriation of monopoly profits by QR at the time of contract renewal.

Whereas, buyers of tenements in other coal regions (such as central Queensland and the Hunter Valley) would not be exposed to this risk.

The risk is actually further heighted here because of the higher proportion of costs that infrastructure costs comprise in the West Moreton coal industry. Leaving aside whether the NCC is correct in its assessment of Port of Newcastle Operations' incentives and ability to raise prices in respect of the Newcastle shipping channel – this is definitely not a case where the potential change in prices is of such a minor magnitude that it will not impact on investment decisions. In that regard, the South West Producers notes the QCA's estimate that the cost of below-rail access accounts for as much as 10-20% of the final FOB price of export thermal coal,[33] and note it forms an even higher proportion at times of lower coal prices.

Consequently, the South West Producers strongly agree with the QCA's conclusions[34] that:

(i) the additional risk and uncertainty are likely to be sufficiently material as to deter efficient entry by prospective miners in the first place; and

(ii) existing tenement holders would also face higher risks without declaration, as they would face the same issue at the point of contract renewal, creating a disincentive to invest in further exploration and development of existing tenements, with the potential to affect competition in the market over time.

It is therefore abundantly clear to the South West Producers, including from the QCA's reasons that, in the absence of declaration, QR would have both the incentive and ability to exercise its market power in this way and that investment in the West Moreton region coal tenements market would be significantly and detrimentally impacted – through deterrence of efficient entry and participation in the market - as a result of the exercise of that power.

Whereas, as the QCA has rightly concluded[35] (and as discussed in section 4.4 of these submissions), the continued certainty of terms, particularly in relation to essential pricing and non-pricing terms, is likely to continue to promote efficient entry and efficient participation in the West Moreton region coal tenements market. In particular, it will completely remove the two-period economic hold-up problem described in detail above and in the QCA's draft decision.

A comparison of those scenarios makes it clear that the environment and opportunities for competition in the tenements market will be materially better with access on reasonable terms as a result of declaration, such that criterion (a) is satisfied.

### 4.9 Port of Brisbane coal handling services market and rail haulage market

The South West Producers appreciate that once the QCA is satisfied that there is a promotion of a material increase in competition in at least one dependent market (the West Moreton coal region tenements market), criterion (a) is satisfied – without technically requiring a detailed assessment of other dependent markets.

However, for completeness the South West Producers continue to stress that the other dependent markets identified (the West Moreton rail haulage market and Port of Brisbane coal handling services market) and the impact on competition with and without declaration, are reflective of exactly the same issues discussed in respect of the West Moreton coal region tenements market.

In particular, the two-period economic hold up problem applies equally to rail haulage providers (both to Aurizon and to any potential new entrant) – who:

(a) cannot invest in rolling stock (and for new entrants maintenance and provisioning facilities) when there are such risks of monopoly pricing expropriating profits at the point of contract renewal (irrespective of whether the contract is held by the coal producer or the rail haulage provider); and

[33] QCA Draft Decision, Part B, page 67.
[34] QCA Draft Decision, Part B, page 68.
[35] QCA Draft Decision, Part B, page 68.

(b) are unlikely to be faced with the significant demand that would facilitate investment in the rolling stock specific to the West Moreton network given the chilling effect a lack of declaration will have on coal investments in the region.

Similar, Queensland Bulk Handling, in providing coal handling services, will effectively see its existing customer base, who currently compete for capacity at the terminal, reduce over time, if not ultimately be eliminated.

Accordingly, the South West Producers continue to consider that competition in the market for West Moreton coal haulage services and coal handling services at the Port of Brisbane would be materially promoted where access to the West Moreton and Metropolitan systems services was available on reasonable terms and conditions as a result of declaration, by virtue of:

(c) the improved environment for competition that results from the constraints on QR provided by the regulatory protections arising from declaration which ensure that profits anticipated from long term investments are not expropriated by QR at the point of contract renewals; and

(d) declaration facilitating continued investment in the West Moreton region coal tenements market (and ultimately future coal developments in the region).

### 4.10 Conclusion

The South West Producers firmly support the QCA's conclusion that access on reasonable terms and conditions as a result of declaration would materially promote competition in at least the West Moreton region coal tenements market (and most likely the West Moreton coal haulage market and Port of Brisbane coal handling services market) such that criterion (a) is satisfied in respect of the West Moreton and Metropolitan systems services.

## 5 Criterion (c) – state significance

### 5.1 Interpretation of criterion (c)

The South West Producers strongly support the QCA's interpretation that criterion (c) is satisfied if the facility is significant having regard to either of the facility's size or its importance to the Queensland economy.[36] That approach clearly reflects the language of criterion (c) which refers to have regard to size *or* importance to the economy.

The South West Producers also agree with the QCA's interpretation[37] that:

(a) in considering the size of a facility, it is the physical and geographic dimensions of the facility, the physical capacity of the facility and throughput of the facility that is relevant; and

(b) in considering the importance of the facility to the Queensland economy, relevant considerations include contribution to exports, employment and gross state product, and that state significant will be established if the facility is an essential element of a supply chain, and enables significant revenues to be earned by businesses participating in dependent markets.

That approach is consistent with the interpretation applied by the NCC.[38]

### 5.2 Size

As the QCA notes,[39] QR's network:

(a) is at least 6,600km and covers a substantial geographic areas of the State; and

(b) carries substantial freight volumes – 19.6 billion gross tonne kilometres in 2017; and

(c) provides substantial passenger services - over 51 million passenger trips in the Metropolitan network and over 760,000 passenger trips in the regional network.

Similarly, the QCA notes[40] the West Moreton and Metropolitan systems:

(d) consist of approximately 612km of track;

(e) transport approximately 7 mtpa of coal, with the capacity to transport over 10 mtpa; and

(f) transport approximately 2,400 million gtk of freight and passengers.

Accordingly, irrespective of whether the network is considered as a whole, or the West Moreton and Metropolitan systems are considered separately, the South West Producers strongly agree with the QCA's conclusions that it is clear from the physical size of the track, area of coverage, substantial throughput and capacity, the facility is significant having regard to its size.

### 5.3 Importance to the Queensland economy

As the QCA notes,[41] QR's network is a vital component of the Queensland economy as it facilities operation of numerous industries which are dependent on access – including mining, agriculture and livestock, above rail operations which support those industries, tourism and metropolitan passenger transport, and generates significant direct access charges, employment and facilitates substantial economic growth and activity.

Similarly, the QCA notes[42]:

[36] QCA Draft Decision, page 26.
[37] QCA Draft Decision, page 26.
[38] NCC, Guide to Declaration, 39-40.
[39] QCA Draft Decision, Part B, pages 74-75.
[40] QCA Draft Decision, Part B, pages 83-86.
[41] QCA Draft Decision, Part B, page 75-76.
[42] QCA Draft Decision, Part B, page 86-88.

(a) the West Moreton system is predominantly funded by its users on a commercial basis; and

(b) makes significant indirect contributions to the economy through supporting and facilitating operations at the Port of Brisbane, rail haulage operations, the West Moreton coal mines, and the related employment, coal royalties and economic activity they generate.

The South West Producers' also note the comments of the Minister for Transport and Main Roads on announcing $28 million of upgrades to the West Moreton system in February 2018 that:[43]

*Each year approximately 7,000 passenger and freight trains travel on this line, supporting the local tourism economy, agriculture and resource sectors.*

*The West Moreton system is a critical link for rail services from Brisbane to the west and south west communities of the state and is a major artery to the Darling Downs, which is predominantly used to transport thermal coal and grains.*

Accordingly, it is clear that the State recognises the critical importance of this part of QR's network even if QR has sought to downplay its importance in submissions in this process.

Accordingly, irrespective of whether the network is considered as a whole, or the West Moreton and Metropolitan systems are considered separately from the balance of the network, the South West Producers strongly agree with the QCA's conclusions that it is clear from the critical role the facility plays in supply chains and the economic activity it facilitates directly and indirectly, the facility is significant having regard to its importance to the Queensland economy.

## 5.4 Conclusion

Accordingly, the South West Producers strongly support the QCA's conclusion that the West Moreton and Metropolitan systems services are significant, having regard to both their size and importance to the Queensland economy such that criterion (c) is satisfied

[43] Minister for Transport and Main Road, Hon Mark Bailey MP, $28 million to keep West Moreton rail network on track, 9 February 2018

# 6 Criterion (d) – promote the public interest

## 6.1 West Moreton and Metropolitan system

The South West Producers acknowledge the QCA's view that it is not able to be satisfied that the QR network (considered as a whole) meets criterion (d) due to the different characteristic of parts of the network and the differing investment effects in different dependent markets that declaration of various parts of the QR below rail access service will produce.[44]

Consequently, this submission focuses on how reasonable terms and conditions as a result of declaration of the West Moreton and Metropolitan access service would promote a material increase in competition in one or more dependent market.

As the QCA rightly points out,[45] it is only appropriate to give limited weight to QR's submissions in relation to public interest interests, where they amount to no more than a 'laundry list' of issues, without supporting evidence.

The South West Producers also note that no submissions have been made to the QCA which in any way dispute or question the public benefits raised by the South West Producers in their earlier submissions.

However, for completeness, each of the public interest issues considered in the QCA Draft Decision are still considered below.

## 6.2 The proposed access framework and lack of restraints without declaration

Further to the analysis presented on QR's proposed access framework in the context of criterion (a) (see section 4.3), the South West Producers:

(a) strongly support the QCA's view[46] that given the proposed access framework is only a draft and there are considerable uncertainties in how it would apply (even if executed), it is not appropriate for the QCA to consider that it represents an alternative scenario for assessing the likely future without declaration;

(b) remain concerned about the proposed access framework (including for the reasons cited by the QCA such as lack of certainty of efficient pricing, the limited term with no certainty as to provision of access beyond that point, the substantial discretion QR has to make future amendments to the framework and the great difficulty that would be encountered in enforcing the framework); and

(c) confirm they agree with each of the concerns expressed by Aurizon Coal in its submission (also cited by the QCA[47]) which reflect the reservations they hold – particularly in relation to the framework providing the ability to price up to the maximum amount the market could bear (such that the framework does not actually provide any constraints on pricing).

Consequently, the QCA is correct to assess how QR would likely behave in a future without declaration, where there are no regulatory or contractual constraints.

## 6.3 Investment in the facility

As noted in more detail in the South West Producers' initial submissions (referred to in the QCA's Draft Decision[48]), declaration – particularly through long term certainty and transparency of

[44] QCA Draft Decision, Part B, pages 93-94.
[45] QCA Draft Decision, Part B, pages 95.
[46] QCA Draft Decision, Part B, pages 96.
[47] QCA Draft Decision, Part B, pages 96.
[48] QCA Draft Decision, Part B, pages 107-108.

reasonable price (through the reference tariff) and non-price terms (through the standard access agreement), has, and will continue to, promote investment in the West Moreton coal industry.

Similarly, as submitted by the South West Producers and concluded by the QCA in relation to criterion (a) above, declaration will promote investment in the West Moreton coal tenements markets.

Given the high proportion of freight on the West Moreton network attributable to coal (92% based on the Figure 14 in the QCA's Draft Decision[49]), those incentives for continued coal investment are necessary to justify further investment in the facility itself.

The application of a reference tariff under the existing declaration (and the resetting of tariffs at the time of QR's Access Undertaking 1) effectively immunised QR from the volume risk associated with the Wilkie Creek mine shutting, and the QCA's presence provides certainty to both QR and access holders / seekers that even with uncertainty around volumes it will be possible to resolve a tariff that mitigates the consequences of such uncertainty of volume.

By contrast, as detailed in the South West Producers' initial submissions, in the absence of declaration, coal companies will cease or reduce investments, due to the potential for QR (as an unconstrained monopolist) to significantly raise prices after coal producers have incurred significant sunk costs in mine development.

That sort of economic hold-up, cannot arise where there are reference tariffs, and the QCA can arbitrate access disputes, as exist under declaration.

The South West Producers also note the continued investments that have been made by QR and the State in bridge replacements and re-sleepering, which suggests that the existing declaration is facilitating (or at least not impeding) continued long life upgrades of that nature.

## 6.4 Investment in markets that depend on access to the service

The South West Producers strongly support the QCA's conclusion[50] that declaration of the West Moreton and Metropolitan systems services would have a net beneficial effect on investment in dependent markets, including in:

(a) the West Moreton coal tenements market (as discussed in criterion (a)); and

(b) the above rail haulage market.

In relation to the above rail haulage market, the South West Producers agree with the submissions made by Aurizon Coal in respect of the affect declaration would have on the above-rail haulage market, which were cited and accepted by the QCA. Specifically, Aurizon Coal submitted that in an environment without declaration, the potential for increased and potentially uncapped charges could materially erode rail operator margins and substantially undermine investment incentives in the rail haulage market. This is the same economic hold-up issue considered above in the context of criterion (a) regarding coal investment decisions.

The South West Producers note that that concern is not just an issue for the existing operator – but in fact it completely undermines the prospects of efficient new entry to the above rail haulage market. That is of critical importance given the aging nature of Aurizon's fleet, such that a new investment decision by Aurizon or new entry decision by a new operator are real alternative possibilities with declaration.

That would also be an issue for any potential new entrant to the market – not just the existing operator – such that declaration is critical for maintaining the prospect of efficient new entry to the above rail haulage market.

[49] QCA Draft Decision, Part B, page 85.
[50] QCA Draft Decision, Part B, page 109-110.

Given the importance of rail infrastructure costs for both coal investments and above rail investments, and the long term nature of such investments, the uncertainty of pricing (and access), will make it difficult if not impossible to provide any certainty to financiers or investors regarding the returns that are achievable. That, at a minimum significantly increases financing costs (thereby reducing profitability and, in turn, the prospects of investment), and more likely simply makes such projects completely unbankable.

Declaration is therefore absolutely critical for continuing to facilitate investment in the dependent markets.

## 6.5 Administrative and compliance costs

The South West Producers strongly support the QCA's conclusions[51] that:

(a) the QCA levy (reflecting the QCA's costs of administering the regime) is a relatively minor cost compared to the coal access charges paid by the South West Producers;

(b) given there is also an allowance in the reference tariffs reflecting QR's administrative and compliance costs, these costs are likely to have a minor effect in terms of the costs burden of QR as a result of declaration;

(c) the administration and compliance costs associated with the regulatory access regime should be balanced against the benefits generated by the regime – including:

    (i) certainty and transparency of access terms, which leads to the promotion of competition and investment in dependent markets; and

    (ii) standard terms and pricing which reduces the costs and timeframes for negotiations and minimises the costs associated with dispute resolution; and

(d) those benefits are likely to outweigh the administrative and compliance costs associated with the regulatory regime (as discussed above and in respect of other criterion).

As the NCC has previously stated *'costs to a service provider that can be compensated for through access charges are unlikely to be relevant to the assessment of the public interest'*.[52] That is the position here, as the users effectively bear both the QCA levy and QR's compliance costs through being incorporated into the reference tariff build up.

The South West Producers also agree that the costs incurred as a result of the undertaking applying to non-coal services on the West Moreton and Metropolitan system appear to be very minor – given that the focus in each regulatory undertaking has been on issues relating to the reference tariffs and other coal related issues.

In any case, criterion (d) involves an assessment not just of the costs arising from declaration, but an assessment of those costs relative to those which would be incurred without declaration.

Given the QR network will remain a multi-user system with or without declaration, administration costs arising from managing a multi-user system will always exist with and without declaration.

However, the South West Producers are concerned that the costs of dealing with QR, as an unregulated monopoly service provider, will match if not exceed those arising from declaration (without the benefits which arise from declaration). In particular:

(a) removing price certainty and the QCA as a potential arbitrator of access disputes is highly likely to result in more costly and protracted negotiations;

[51] QCA Draft Decision, Part B, pages 110-112.
[52] NCC, Guide to declaration, [6.17].

(b) the costs of the QCA regulatory process are likely to be significantly less than the costs which would need to be incurred by users if they were to use the formal court dispute processes to try to resist QR amending or breaching the access framework in the future.

## 6.6 Regional development and environmental issues

The South West Producers welcome and support the QCA's conclusion[53] that access to the West Moreton and Metropolitan systems services as a result of declaration promotes investment in regional markets, which produces beneficial flow-on effects for employment and regional development (as detailed in the South West Producer's initial submissions.

While, the South West Producers acknowledge that it could be argued that employment and regional development would still occur to some extent in the absence of declaration, they firmly believe that declaration provides additional employment and regional development. That is particularly clear at this point given the investment decisions in the coal industry and rail haulage industry that are to be made in the near future, and which are far less likely to be positive in the absence of declaration.

The South West Producers also agree that there is a beneficial effect of promoting rail haulage over road haulage – particularly when the theoretical alternative is road haulage through metropolitan areas with associated safety, noise and environmental issues.

To the extent that the QCA has raised the issues of train noise and sharing of rail paths with passenger services in Metropolitan regions, the South West Producers note that the South West Producers and their rail haulage operator make every effort to reduce noise and the alternatives are either trucking (which the QCA recognises is problematic) or the elimination of coal services (which removes all the investment and economic benefits discussed earlier in this submission and creates a massive public funding issues as discussed below).

## 6.7 Public funding issues

Finally, the material public benefits to the State financiers arising from declaration are an important public interest factor.

It should be beyond dispute that a rail line that either largely or wholly supports itself through commercial activities is preferable to one the State is required to heavily subsidise – particularly where closing the line is unlikely to be a practical option due to the importance to passenger services and agricultural freight – such that a decline in coal volume will quickly translate to a further funding deficit for the State.

The data provided by the QCA,[54] indicates that 84% of below rail revenue was generated by coal services. Given the extent of fixed costs that QR appears to have (particularly based on the lack of variability in its cost forecasts provided in respect of its proposed replacement access undertaking), if those volumes were removed or reduced, much of that nearly $29 million of coal driven access charges would need to be supported by the State via transport service contract subsidies.

When that is compounded by the loss of coal royalties which would also be occurring at the same time as a result of the decline in coal investment and production, the net reduction in the State's financial position – and the pressure that puts on the State to reduce other services or investments – is clearly not in the public interest.

The South West Producers consider this clearly demonstrates why the chilling effect on coal investment is not just an issue for coal producers, but a public detriment.

[53] QCA Draft Decision, Part B, page 112.
[54] QCA Draft Decision, Part B, page 114.

## 6.8 Conclusion

The South West Producers strongly support the conclusion that access to the West Moreton and Metropolitan systems services on reasonable terms and conditions as a result of declaration would promote the public interest as a result of the beneficial impact on competition in dependent markets, investment in dependent markets, limited administration and compliance costs relative to the benefits derived and benefits to regional development, environmental and safety issues and State funding, such that criterion (d) is satisfied.

For the reasons set out above the South West Producers both consider it is clear, and the QCA is correct in its draft findings, that each of the access criteria are satisfied in respect of the service provided by the West Moreton and Metropolitan networks. The South West Producers therefore strongly support the QCA's recommendation that that service be declared for a period of 15 years.