Queensland Competition Authority

Staff issues paper

Declaration reviews: applying the access criteria

April 2018

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SUBMISSIONS

Closing date for submissions: 30 May 2018

The Queensland Competition Authority (QCA) has commenced a review into whether the declared services specified in s. 250 of the *Queensland Competition Authority Act 1997* (QCA Act) should remain declared in whole or in part following the expiry of the existing declarations on 8 September 2020.

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Staff have prepared this paper to assist stakeholders to make submissions and comment on the application of the access criteria. Submissions are invited from interested parties by **5pm Brisbane time on 30 May 2018**. The QCA will consider all submissions received by this date.

Submissions, comments or inquiries regarding this paper should be directed to:

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Confidentiality

In the interests of transparency and to promote informed discussion and consultation, the QCA intends to make all submissions publicly available. However, if a person making a submission believes that information in the submission is confidential, that person should claim confidentiality in respect of the document (or the relevant part of the document) at the time the submission is given to the QCA and state the basis for the confidentiality claim.

The assessment of confidentiality claims will be made by the QCA in accordance with the *Queensland Competition Authority Act 1997*, including an assessment of whether disclosure of the information would damage the person's commercial activities and considerations of the public interest.

Claims for confidentiality should be clearly noted on the front page of the submission. The relevant sections of the submission should also be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two versions of the submission (i.e. a complete version and another excising confidential information) could be provided.

A confidentiality claim template is available on request. We encourage stakeholders to use this template when making confidentiality claims. The confidentiality claim template provides guidance on the type of information that would assist our assessment of claims for confidentiality.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office, or on the website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact us on (07) 3222 0555.

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CONTEXT

Amendments to the access criteria in section 76 of the QCA Act commenced on 29 March 2018.

On 4 April 2018, the QCA commenced its reviews into whether to recommend that, pursuant to section 87A of the QCA Act, the declared services specified in section 250 of the QCA Act should remain declared for third party access under Part 5 of the QCA Act following the expiry of the existing declarations. These are services provided by Aurizon Network Pty Ltd (Aurizon Network), Queensland Rail Ltd (Queensland Rail) and DBCT Management Pty Ltd (DBCT Management).

The amended access criteria, which the QCA is required to consider for the purposes of its reviews, have not previously been applied. Staff have therefore prepared this paper to assist stakeholders to make submissions on the application of the access criteria. This staff paper:

- offers preliminary views on how the relevant criteria could be interpreted and applied
- invites stakeholders to consider and comment on specific matters as part of making submissions. Nevertheless, it is open for stakeholders to determine whether there are any additional matters on which they wish to comment.

Key dates

Submissions are due by 5pm Brisbane time on 30 May 2018. The QCA will consider all submissions received by this date and take these into account in making its draft recommendations.

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1 INTRODUCTION

Disclaimer: This material has been prepared by QCA staff and does not bind, nor does it represent the views of, the QCA.

1.1 Scope of the third party access declarations

The objective of third party access is to provide a regulatory framework to enable access seekers (users) to gain access to significant infrastructure services where there may be a lack of effective competition.[1]

Section 250 of the QCA Act provides that three specific services are each taken to be declared by the Minister under Part 5, Division 2 of the QCA Act. In summary, those services are:

- the use of a coal system for providing transportation by rail. The relevant 'coal system' is defined[2] and includes the Blackwater, Goonyella, Moura and Newlands systems
- the use of rail transport infrastructure for providing transportation by rail where (in summary) the railway manager is Queensland Rail, or its successor, assign or subsidiary
- the handling of coal at Dalrymple Bay Coal Terminal (DBCT) by the terminal operator.

Declaration gives rise to rights and obligations in relation to the negotiation of the terms of access to the declared service. These rights and obligations are contained in the QCA Act, as well as access undertakings for the declared service approved by the QCA or, if parties are unable to agree on access to the declared service, by determinations made by the QCA under Part 5 of the QCA Act. The declarations do not apply to the entities themselves but relate to relevant services provided by these entities.

1.2 The QCA's role in the declaration reviews

Each of the existing declarations expire on 8 September 2020.[3] At least six months, but not more than 12 months, before the expiry date of each declaration, the QCA must recommend to the Treasurer that, with effect from the expiry date:

(a) the service be declared; or

(b) part of the service, that is itself a service, be declared; or

(c) the service not be declared.[4]

In each case, the relevant declared service is defined in section 250 of the QCA Act. These are the services about which the QCA must make a recommendation under section 87A of the QCA Act. The only flexibility given to the QCA by section 87A(1) is to consider whether all or a part of

[1] The object of Part 5 is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets (Section 69E of the QCA Act).

[2] Section 250(3) and 250(4) of the QCA Act.

[3] Section 250(2) of the QCA Act states that the existing declarations stop having effect at the end of the 'expiry day' or when revoked. Section 248 states the 'expiry day' 'means the day that is 10 years from the day this section commences'. Section 248 commenced on the date the *Motor Accident Insurance and Other Legislation Amendment Act 2010* (Qld) received assent (that is, 8 September 2010).

[4] Section 87A of the QCA Act.

that service (which is itself 'a service' within the meaning of section 72 of the QCA Act) should be declared. The QCA Act makes no other provision for the QCA to modify the scope of the declared services through this review process.

The QCA must also consider what an appropriate period for each declaration is (if it considers that the services or part thereof should be declared). Staff note that potentially relevant factors to forming a view on this matter may include:

- the importance of long-term certainty to access seekers who may engage in significant investments as part of gaining access to a declared facility
- the duration of time for which users may seek access to the facility (for example considering average mine lives)
- the foreseeable timing of potential changes in the market environment, including the likelihood that the service no longer satisfies the natural monopoly test in criterion (b)
- the need for periodic reviews of declaration arrangements.[5]

1.2.1 Declaration reviews and access resets

Staff note that there may be some overlap in timeframes between the declaration reviews and the QCA's regular access reset processes. For instance, submissions on the QCA's draft decision on UT5, Aurizon Network's 2017 draft access undertaking (DAU) were due on 12 March 2018. Likewise, Queensland Rail's DAU for the next undertaking period is due on 31 July 2018 (in response to the QCA's initial undertaking notice of 14 September 2017) and DBCT Management's DAU for the next undertaking period is due on 1 July 2019 (in response to the QCA's initial undertaking notice of 12 October 2017).

The declaration and access reset reviews are separate processes and are subject to separate requirements (s. 76 and s. 138 respectively). Stakeholders should therefore be aware of the following:

- Each review process will be undertaken separately, on its merits and in accordance with the relevant assessment criteria.
- Any draft or final QCA position in respect of one matter does not pre-suppose a conclusion in the other matter.
- Submissions should be made on each process separately.[6]

[5] Refer also to National Competition Council, *Declaration of Services: A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth),* version 4, February 2013, p. 54. http://ncc.gov.au/images/uploads/Declaration_Guide_2013.pdf.

[6] That said, QCA may have regard to any publicly available material as part of the declaration review. This may include stakeholder submissions on other processes that are made publicly available on the QCA's website.

2 APPROACH TO THE CRITERIA

2.1 The access criteria

Section 76 of the QCA Act sets out the access criteria which the QCA must apply in making a recommendation on whether all or part of each declared service should continue to be declared or not (Box 1).

Box 1: Section 76 — Access criteria[7]

(2) The access criteria are as follows —

(a) That access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the service;

(b) that the facility for the service could meet the total foreseeable demand in the market —

(i) over the period for which the service would be declared; and

(ii) at the least cost compared to any 2 or more facilities (which could include the facility for the service);

(c) that the facility for the service is significant, having regard to its size or its importance to the Queensland economy;

(d) that access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service would promote the public interest.

(3) For subsection (2)(b), if the facility for the service is currently at capacity, and it is reasonably possible to expand that capacity, the authority and the Minister may have regard to the facility as if it had that expanded capacity.

(4) Without limiting subsection (2)(b), the cost referred to in subsection (2)(b)(ii) includes all costs associated with having multiple users of the facility for the service, including costs that would be incurred if the service were declared.

(5) In considering the access criterion mentioned in subsection (2)(d), the authority and the Minister must have regard to the following matters —

(a) if the facility for the service extends outside Queensland —

(i) whether access to the service provided outside Queensland by means of the facility is regulated by another jurisdiction; and

(ii) the desirability of consistency in regulating access to the service;

(b) the effect that declaring the service would have on investment in —

(i) facilities; and

(ii) markets that depend on access to the service;

(c) the administrative and compliance costs that would be incurred by the provider of the service if the service were declared;

(d) any other matter the authority or Minister considers relevant.

2.2 Historical perspective

The origins of the access criteria in Part 5 of the QCA Act lie in the national competition policy reforms implemented by the Commonwealth, States and Territories in the 1990s.

In 1992, following agreement from all jurisdictions on the need for a national competition policy, the Commonwealth commissioned an independent Committee of Inquiry on National

[7] As amended by the *Queensland Competition Authority Amendment Act 2018* (Qld)

Competition Policy. A key focus of the Committee was the extent to which the owner of a significant monopoly infrastructure facility could exert monopoly power in upstream and downstream markets.

Among other things, the Committee recommended the development of a national access regime which would allow third parties ('access seekers') to gain access to the services provided by natural monopolies.[8]

Following the release of the Committee's report, all jurisdictions signed up to the 1995 Competition Principles Agreement (CPA).[9] Clause 6 of this agreement provided that:

- the Commonwealth would implement legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities (cl. 6.1)
- the Commonwealth legislation would not cover a service provided by means of a facility where the State or Territory has an access regime in place that the National Competition Council (NCC) considers is an effective access regime (cl. 6.2).

As a result of the CPA, the Commonwealth subsequently amended the *Trade Practices Act 1974* (Cth) (now the *Competition and Consumer Act 2010* (Cth) (CCA)) to include a new access regime set out in Part IIIA, including the criteria in respect of which the relevant Minister must be satisfied to make a declaration.

In 1997, the Queensland Government passed the QCA Act that included a third party access regime in Part 5 which reflected the State's commitment to a national access regime. In 1998 and 2001, the Queensland Government amended the *Queensland Competition Authority Regulation 1997* (Qld) to respectively declare the rail and port services that are now the subject of this review.

On 8 September 2010, the *Motor Accident Insurance and Other Legislation Amendment Act 2010* (Qld) received assent. This Act amended the QCA Act to (among other things) insert the above mentioned declarations in s. 250 of the QCA Act.

On 17 June and 16 December 2010 respectively, the Queensland Government applied to the National Competition Council (NCC) for certification of the Queensland Rail[10] and DBCT access regimes as effective access regimes for the purposes of Part IIIA of the CCA.[11] Both regimes were certified, on 19 January 2011 and 11 July 2011 respectively, with the Commonwealth Treasurer

[8] Committee of Inquiry on National Competition Policy, *National Competition Policy Review*, 25 August 1993, http://ncp.ncc.gov.au/docs/National%20Competition%20Policy%20Review%20report%2C%20The%20Hilmer%20Report%2C%20August%201993.pdf; See also Productivity Commission, *National Access Regime*, inquiry report no. 66, 25 October 2013, p. 46–47, http://www.pc.gov.au/inquiries/completed/access-regime/report/access-regime.pdf.

[9] Council of Australian Governments, *Competition Principles Agreement—11 April 1995*, as amended to 13 April 2007, http://ncp.ncc.gov.au/docs/Competition%20Principles%20Agreement,%2011%20April%201995%20as%20amended%202007.pdf.

[10] Queensland Rail was created in 2010 when the Queensland Government split the former QR Ltd. Queensland Rail owns most of the former QR Ltd rail network in Queensland, apart from the tracks in central Queensland owned by Aurizon Network Pty Ltd (formerly QR Network Pty Ltd).

[11] Queensland Government, *Application to the National Competition Council for a recommendation on the effectiveness of an access regime: Queensland Third Party Access Regime for Rail Services provided by Queensland Intrastate Rail Network*, 17 June 2010; Queensland Government, *Application to the National Competition Council for a recommendation on the effectiveness of an access regime: Queensland Third Party Access Regime for coal handling services at Dalrymple Bay Coal Terminal*, December 2010.

stating that both regimes were consistent with the principles for an effective access regime in the CPA.[12]

The Commonwealth amended the access criteria in Part IIIA of the CCA through the *Competition and Consumer Amendment (Competition Policy Review) Act 2017* (Cth) with effect from 6 November 2017.

In March 2018, the Queensland Parliament amended the access criteria in section 76 of the QCA Act through the *Queensland Competition Authority Amendment Act 2018* (Qld), to reflect the updated criteria introduced at the national level.

2.3 Approach to interpretation of the access criteria

The origins of both the Commonwealth and Queensland access regimes are grounded in the national competition policy reforms of the 1990s, and the access criteria in Part 5 of the QCA Act are similarly worded to the criteria in Part IIIA of the CCA. Application of the access criteria under Part IIIA of the CCA has been considered by the High Court of Australia, the Federal Court of Australia, the Australian Competition Tribunal (ACT), relevant Ministers and the NCC.

Staff are considering the extent to which these previous decisions, as well as extrinsic materials (such as explanatory memoranda) and the NCC's guidelines for assessing applications for declaration,[13] provide guidance on the interpretation and application of the access criteria. Staff's view is that it is appropriate to draw on this material where it is relevant to the amended criteria, in particular decisions of the High Court and Federal Court relating to Part IIIA.

2.4 Interpretation of relevant provisions

Staff's preliminary views of how the access criteria could be interpreted and applied are discussed in the following chapters.

Criterion (b) is considered first (Chapter 3), before criterion (a), as it provides greater clarity to the analysis of relevant markets. In particular, criterion (b) focuses on the nature of the service provided by the regulated entity and the market within which the service is provided. A discussion of criterion (a) (Chapter 4) then seeks to explore impacts in dependent markets, both upstream and downstream. A discussion of criteria (c) and (d) then follows in Chapters 5 and 6 respectively.

[12] Parliamentary Secretary to the Treasurer, *Statement of reasons - decision on the effectiveness of the Dalrymple Bay coal terminal access regime*, 11 July 2011, http://ncc.gov.au/images/uploads/CECTQlSoR-001.pdf; Parliamentary Secretary to the Treasurer, *Statement of reasons - decision on the effectiveness of the Queensland Rail access regime*, 19 January 2011, http://ncc.gov.au/images/uploads/CERaQldMD-002.pdf.

[13] See National Competition Council (NCC), *Declaration of Services, A guideline to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth)*, version 4 (February 2013), http://ncc.gov.au/images/uploads/Declaration_Guide_2013.pdf; and version 5 (December 2017), http://ncc.gov.au/images/uploads/Declaration_Guide_2017.pdf; see also NCC, A *guideline to declaration under Part IIIA of the Trade Practices Act 1974*, August 2009, http://ncc.gov.au/images/uploads/Declaration_Guide.pdf.

3 CRITERION (B): THE FACILITY FOR THE SERVICE COULD MEET THE TOTAL FORESEEABLE DEMAND IN THE MARKET

Section 76(2)(b) of the QCA Act provides:

> that the facility for the service could meet the total foreseeable demand in the market-
>
> (i) over the period for which the service would be declared; and
>
> (ii) at the least cost compared to any 2 or more facilities (which could include the facility for the service);

Section 76(3) and (4) further state:

> (3) For subsection (2)(b), if the facility for the service is currently at capacity, and it is reasonably possible to expand that capacity, the authority and the Minister may have regard to the facility as if it had that expanded capacity.
>
> (4) Without limiting subsection (2)(b), the cost referred to in subsection (2)(b)(ii) includes all costs associated with having multiple users of the facility for the service, including costs that would be incurred if the service were declared.

3.1 Identify the service

Staff's preliminary view is that the starting point to the interpretation of criterion (b) is identification of the relevant service.

In each case the service which is taken to be declared is identified in section 250 of the QCA Act.

Staff note that the QCA is required to recommend that the service be declared; that part of the service (that is itself a service) be declared; or that the service not be declared (section 87A(1) of the QCA Act).

For the purpose of Part 5 of the QCA Act, 'service' is defined in section 72 of the QCA Act as follows:

> (1) Service is a service provided, or to be provided, by means of a facility and includes, for example:
>
> (a) the use of a facility (including, for example, a road or railway line); and
>
> (b) the transporting of people; and
>
> (c) the handling or transporting of goods or other things; and
>
> (d) a communication service or similar service.
>
> (2) However, service does not include:
>
> (a) the supply of goods (except to the extent the supply is an integral, but subsidiary, part of the service); or …

3.2 Identify the facility

Staff's preliminary view is that the interpretation of criterion (b) also requires identification of the relevant facility for each service, and defining material features including existing capacity and expandable capacity.

A 'facility' is defined in section 70 of the QCA Act as follows:

> (1) Facility includes:

(a) rail transport infrastructure; and

(b) port infrastructure; and

(c) electricity, petroleum, gas or GHG stream transmission and distribution infrastructure; and

(d) water and sewerage infrastructure, including treatment and distribution infrastructure.

...

In this case, section 250 of the QCA Act defines the declared services as services which entail the use of certain types of facilities. Staff consider that the descriptions in section 250 of the QCA Act also identify the facilities for each declared service.

3.3 Concept of a 'market'

Central to determining whether criterion (b) is satisfied is an understanding of the market in which the facility in question provides the service.

The concept of a 'market' is defined in section 71 of the QCA Act as follows:

(1) A market is a market in Australia or a foreign country.

(2) If market is used in relation to goods or services, it includes a market for–

(a) the goods or services; and

(b) other goods or services that are able to be substituted for, or are otherwise competitive with, the goods or services mentioned in paragraph (a).

A key aspect in defining a market is substitutability. In *Re QCMA*,[14] the then Trade Practices Tribunal defined a market as:

> ... the area of close competition between firms or, putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution — substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another. As well, on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives.
>
> It is the possibilities of such substitution which sets the limits upon a firm's ability to "give less and charge more". Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to "give less and charge more" would there be, to put the matter colloquially, much of a reaction? And if so, from whom? In the language of economics the question is this: From which products and which activities could we expect a relatively high demand or supply response to price change, ie, a relatively high cross-elasticity of demand or cross-elasticity of supply?

This approach was endorsed by the High Court in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd*.[15]

[14] *Re Queensland Co-operative Milling Association* (1976) ATPR 40-012 at [17247].
[15] (1989) 167 CLR 177 at [15]-[17].

A market is typically defined by reference to its product and geographic dimensions.[16] [17]

A market involves actual and potential substitution. Substitution possibilities will be influenced by a range of factors, including: regulatory/legislative frameworks; economic considerations such as the cost of switching to alternative services; contractual arrangements; and geographic and operational constraints. For example, transportation costs or long term contracts may limit substitutability between otherwise similar services.

Moreover, where a buyer has been using the service provided by a facility and accesses the service provided by another facility, it may be appropriate to examine the reasons for that behaviour. For example, was the use of another facility's service in response to a price or incentive change, or did it reflect availability issues of the original supplier? If the latter, an issue may arise as to whether the services provided by the two facilities are sufficiently close substitutes to be in the same market.

Appendix A contains a legal opinion on how a market is to be defined for the purposes of criterion (b) in the context of the declaration reviews. Stakeholder views on this opinion are requested. Given this document is a staff issues paper, the opinion does not represent the views of the QCA at this stage, but rather (subject to considering stakeholder comments), it outlines an approach that could be adopted for the purposes of the pending draft recommendation. Stakeholders are encouraged to provide legal opinions, where necessary, as part of providing comments on this opinion.

3.3.1 Identify customers and competitors in the market

Having identified the scope of the relevant market for each service provided by each facility in question, staff consider it appropriate to identify:

- customers in the market and the foreseeable demand for each service over the proposed period of declaration;
- competitors in the market, their facilities and the services offered over the proposed declaration period.

An assessment of competitors in the market involves an assessment of the specific market within which the service in question is provided. Care must therefore be exercised to define the market in which the declared service is provided, and to distinguish this from other markets, particularly dependent markets.

Other facilities

Staff's preliminary view is that criterion (b) only requires an identification and assessment of the cost at which total foreseeable demand could be met by facilities that will be (or are likely to be) in operation during the period for which the service would be declared. As such, staff view is that it is not relevant to consider:

- hypothetical facilities; or

[16] A market can also be defined having regard to its functional characteristics.

[17] Staff note in competition law cases involving market definition, a 'small but significant and non-transitory increase in price' (SSNIP) test (or at least the conceptual framework for this test) may provide an insight into how to define the relevant market. Refer to Productivity Commission, *National Access Regime*, inquiry report no. 66, 25 October 2013, p. 163, http://www.pc.gov.au/inquiries/completed/access-regime/report/access-regime.pdf

- facilities which are unlikely to be in operation during the declaration period.

Staff note that the issues that may be relevant to forming a view on whether yet-to-be constructed facilities should be considered as part of the assessment process for criterion (b) may include:

- the likelihood that that the facility will be in operation over the period for declaration
- when the facility is expected to become operational (i.e. early or late in the period for assessing foreseeable demand)
- the availability, accuracy and certainty of cost of service provision information for these facilities.

Staff invite stakeholder feedback, including through the provision of legal opinions, on the extent to which hypothetical or yet-to-be constructed facilities are relevant to the application of criterion (b).

3.4 A 'natural monopoly' test

Having defined the relevant market, criterion (b) invites consideration of whether the facility that provides the service is a 'natural monopoly' in the marketplace. This was confirmed by the explanatory memorandum that accompanied the Commonwealth Parliament's amendments to the CCA:

> The amendment to this paragraph [44CA(1)(b)] is intended to refocus the test to a 'natural monopoly' test instead of a private profitability test [para 12.22]

The explanatory memorandum for the amendments to the QCA Act confirmed that the changes to the legislation were intended to reflect the amended declaration criteria in Part IIIA. The second reading speech for the Queensland amendments also confirmed that:

> the bill will clarify the law in light of a 2012 High Court decision which changed the test for regulation from 'uneconomic to duplicate' to one of 'private profitability'. The amendment will restore the previous test rather than the one that considers whether it is profitable for anyone to develop another facility.

The key characteristics of a natural monopoly are the presence of significant economies of scale and/or economies of scope in the production of the relevant service or services; the existence of substantial sunk fixed (or capital) costs; and relatively low variable (or operating) costs. These characteristics may imply that it is economically efficient for only one facility to satisfy given or likely demand. In such situations, the development of multiple facilities to provide the service would amount to a wasteful use of the community's resources.[18]

The focus of criterion (b) is whether the facility that provides the declared service can, by itself, meet total foreseeable market demand (in existing or expanded form) at a lower cost than through 2 or more facilities (which could (but need not) include the facility for the service).

Its focus is on social economic welfare in a broad sense and not the interests of any particular party. The object of Part 5 of the QCA Act is also relevant in this respect, namely:

> to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets.[19]

[18] See for example *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [137].
[19] Section 69E of the QCA Act.

In this context, staff consider that criterion (b) is a test of how resources can be allocated to meeting demand optimally—from a social economic welfare perspective—rather than whether it is in the private commercial interests of an entity to meet demand in an inefficient way (i.e. at higher cost than through an alternative means).[20]

Criterion (b), in its previous form, has also been interpreted by the NCC as setting down a natural monopoly test:

> access regulation should be limited to infrastructure where competing facilities are not economically viable. As such, access regulation should be normally confined to infrastructure exhibiting natural monopoly characteristics – that is, where a single facility can meet market demand at less cost than two or more facilities. Such a facility is normally characterised by large up-front costs and low operating costs...[21]

This approach was subsequently endorsed by the ACT in the *Duke EGP* decision:

> We agree with the submissions of NCC that the "test is whether for a likely range of reasonably foreseeable demand for the services provided by means of the pipeline, it would be more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one".[22]

While the text of criterion (b) in the QCA Act is paramount (and different to its predecessor), there is substantial congruence in criterion (b) in both Part 5 of the QCA Act and Part IIIA of the CCA, with the articulated approach of the NCC and ACT to criterion (b) in its previous form.

Given this, staff are of the view that previous NCC recommendations and Tribunal decisions on criterion (b) in the context of Part IIIA are relevant and should be considered as part of evaluating whether criterion (b) in the context of Part 5 of the QCA Act is satisfied. Stakeholders are invited to comment on whether they agree with this approach.

Staff note that criterion (b) requires an assessment of whether the facility for the service can meet 'total foreseeable demand' for the relevant period at 'least cost'. Staff's initial view is that such an assessment requires examining whether the cost of meeting foreseeable demand, by the facility in question, is lower than that by using two or more facilities.

[20] See also NCC, *A guideline to declaration under Part IIIA of the Trade Practices Act 1974* (Cth), August 2009, at para 4.2.

[21] NCC, *Application for Coverage of Eastern Gas Pipeline (Longford to Sydney),* final recommendation, June 2000, http://ncc.gov.au/images/uploads/GCEgRe-001.pdf, at p. 42.

[22] *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [137].

In making this assessment, staff consider that even if the facility does not have spare capacity but can be expanded to meet foreseeable demand at least cost compared to any two or more facilities, criterion (b) is satisfied.[23] [24]

Where the facility in question would need to be expanded to meet foreseeable demand, staff's initial view is that test would involve:

- assessing existing costs of service provision
- assessing the incremental costs of any expansion as is necessary for the facility to meet total foreseeable demand
- comparing the cost of meeting total foreseeable demand at the facility in question to the costs of at 2 or more facilities (which may include the facility in question)
- forming a view on whether the facility in question can satisfy total foreseeable demand at least cost compared to 2 or more facilities.

In doing so, staff consider that it is not essential to establish precise costs of service provision for each alternative service offering. Rather, it simply needs to be established whether the facility providing the regulated service offering can satisfy total foreseeable demand more cheaply than a combination of facilities. Staff consider that existing tariffs (in particular those approved through a regulatory process) may be an appropriate indicator of the existing cost of service provision. Where quantitative cost information is unavailable, a qualitative analysis may need to be undertaken. Staff note that cost information can also be collected from estimates of construction costs and benchmarking data amongst other sources, though there may be conflicting stakeholder views on the relevance or magnitude of these estimates.

Staff note that the explanatory memorandum for the amendments to the access criteria in Part IIIA of the CCA expresses the intention that, in determining the costs of meeting total foreseeable demand, the administrative and compliance costs of regulation are not considered to be relevant to criterion (b), and that these are to be separately considered under criterion (d). However, staff also note that section 76(4) (which is similar to section 44CA(2)(b) of the CCA) states that the costs to be considered include all costs associated with having multiple users of the facility for the service, including the costs that would be incurred if the service were declared.

Staff's preliminary view is that the costs of an application for declaration are not relevant as these are costs which precede declaration of a service. Furthermore, if the application is successful, the regulated entity's regulatory costs after declaration (for instance related to access undertaking processes) are not relevant to an assessment under criterion (b). Rather these are relevant matters for criterion (d), which requires, among other things, having regard to the administrative and compliance costs that would be incurred by the service provider if the service were declared.

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[23] Section 76(3) of the QCA Act provides that for this criterion, '…if the facility for the service is currently at capacity, and it is reasonably possible to expand that capacity, the authority and the Minister may have regard to the facility as if it had that expanded capacity.'

[24] Staff note that both average cost and incremental cost concepts have been used in previous assessments of criterion (b) in Part IIIA. For example, as part of its Final Recommendation in the Eastern Gas Pipeline matter, the NCC considered the average costs of service provision (see NCC, *Application for coverage of Eastern Gas Pipelines (Longford to Sydney)*, final recommendation, June 2000, at p. 54). Likewise, in the same matter, the ACT examined estimates of incremental costs and incremental tariffs of developing the Interconnect and the Eastern Gas Pipeline such that they could satisfy foreseeable demand (see *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [139]).

Staff's understanding is consistent with the view expressed by the NCC.[25] Staff invite submissions, including legal opinions if necessary, to the extent that stakeholders consider an alternative view is appropriate.

As per section 76(2)(b)(i) of the QCA Act, the QCA will assess foreseeable demand over the time period for declaration. Staff note that this period will be determined following consideration of submissions.

3.5 Summary of approach to criterion (b)

In evaluating whether criterion (b) is satisfied, staff's preliminary view is that the following approach could apply:

(a) identify the relevant service (i.e. as defined in s. 250 of the QCA Act)

(b) identify the facility used to provide the service (and define its features including existing and expandable capacity)

(c) identify the market in which the service is provided, including customers and potential competitors (i.e. any substitute services provided by other facilities) in the relevant market, and consider the extent to which other facilities are substitutable for the facility for the declared service

(d) identify the period for which the service would be declared [26]

(e) identify total foreseeable demand in the market

(f) identify whether, and at what cost, the facility for the service (expanded if necessary) could meet total foreseeable demand

(g) identify and compare the cost of any two or more facilities (whether new or existing) to meet total foreseeable demand.

A hypothetical worked example illustrating how such an approach might operate is provided in Appendix B.

[25] See NCC, *Declaration of Services: A guide to declaration under Part IIIA of the Competition and Consumer Act 2010 (Cth)*, version 5, December 2017, at para 4.12-4.14.

[26] The factors staff consider would be relevant as part of determining the declaration period include those outlined in s. 1.2 of this paper.

Staff consultation questions – Criterion (b)

(1) Do you agree with staff's proposed interpretation of criterion (b)? If not, what do you consider is an appropriate approach to interpreting criterion (b)?

(2) Subject to the above question, what information and analysis in respect of the matters (a) to (g) in section 3.5 above are relevant to assessing whether this criterion is satisfied for each declared service?

General

(3) Have there been changes in the market conditions and structure since the service was declared that are relevant to assessing criterion (b)? If so, identify the changes and the relevance of those changes to criterion (b) (with reference to the proposed assessment methodology). Where possible, please provide evidence and data to support your position.

Identify the relevant service

(4) Each declared service is defined in section 250 of the QCA Act. Are there any additional factors relevant in identifying the service?

Identify the relevant facility

(5) What is the relevant facility?

(6) What is the current capacity of the relevant facility?

(7) Is it reasonably possible to expand the capacity at the facility? If so, to what extent, at what cost and in what timeframe?

Identify the relevant market including identify customers and competitors in the market

(8) What is the market in which the declared service is provided?

(9) Are costs ancillary to accessing the declared service relevant in determining whether there is/will be actual or potential substitution between the services of competing facilities (i.e. whether the services are in the same market)? For example, to access the coal handling facility at a terminal, miners need access to above and below rail services. If so, what are these ancillary costs and their magnitude? Please provide information for services provided by competing facilities where relevant.

(10) Identity of customers for each service. What factors should be considered in identifying customers/likely potential customers for each service, for example, contractual arrangements and physical location of a customer's facility?

(11) To what extent do other facilities provide a substitutable service, including in terms of product mix, location, costs, availability and ease of access by access seekers? Please provide supporting quantitative and qualitative data and evidence.

(12) Is the 'small but significant and non-transitory increase in price' (SSNIP) test, or at least the conceptual framework on which it is based relevant to the QCA's assessment of the relevant market? If so, how would it be applied?

(13) If some customers were to use an alternative facility due to reasons other than price or incentive (for example the facility providing the declared service was not

available), is the alternative facility a sufficiently close substitute to be in the same market as the declared service facility?

(14) What constraints and barriers, if any, exist which would limit/prevent substitution possibilities between the declared service and services provided by other facilities?

(15) What are actual and/or potential competing services in the market that may be substitutable for the declared service? In particular,

(a) To what extent is a hypothetical facility or yet-to-be constructed facility relevant to the QCA's assessment?

(b) For the below rail services provided by Aurizon Network and Queensland Rail, will the Carmichael Coal and Rail project[27] and the Inland Rail Project[28] provide services in the same market(s)? Also, what is the relevance of other proposed rail projects to the QCA's assessment?[29]

(c) For the coal handling service provided at DBCT, are there other facilities providing services in the same market? In considering this question, please comment on to what extent users can access the coal handling services provided at other terminals, including Abbott Point and Hay Point, and whether they operate in the same market as the declared DBCT service. Stakeholders are requested to have regard to the legal opinion in Appendix A in responding to this question.

(d) What is the relevance, if any, of existing access contracts which may limit/prevent an access seeker's use of a competitor's service offering?

Period for assessing demand

(16) What matters should the QCA have regard to in determining the appropriate period of any declaration?

(17) What is the appropriate period for declaration for each service and why?

Foreseeable demand

(18) What is total foreseeable demand in the market over the relevant period? Relevant information may include that related to access agreements, market conditions, binding and non-binding expressions of interest in capacity and from facility masterplans.

[27] An Adani Mining project that comprises a planned open cut and underground coal mine with a yield of 60 million tonnes per annum in the Galilee Basin and a 189 kilometre railway line that will connect with the existing Goonyella rail system. (https://www.statedevelopment.qld.gov.au/assessments-and-approvals/carmichael-coal-mine-and-rail-project.html).

[28] A freight line/infrastructure upgrades between Melbourne and Brisbane that has been approved for construction. The Australia Rail Track Corporation expects it to be operational in 2024-2025. (https://inlandrail.artc.com.au/)

[29] The Department of State Development, Manufacturing, Infrastructure and Planning website provides information on another Adani proposal – the North Galilee Basin Rail Project. This project relates to a 310 kilometre standard gauge, greenfield rail line in Central Queensland, connecting the northern Galilee Basin to the Port of Abbot Point (https://www.statedevelopment.qld.gov.au/assessments-and-approvals/north-galilee-basin-rail-project.html). Staff also note that Aurizon has withdrawn its application to the Northern Australia Infrastructure Facility (NAIF) 'for funding to assist with a rail solution for the development of the Galilee Basin' (https://www.aurizon.com.au/news/news/aurizon-to-withdraw-naif-application).

Satisfying total foreseeable demand at least cost

(19) What are the costs of service provision for the facility in question as well as competing facilities?

(20) Does the facility for the service or competing facilities have excess capacity?

(21) What are the unit costs of service provision under any expansion at the facility for the service? Are prevailing tariffs an appropriate indicator of cost?

(22) Are expansions at competing facilities (if there are any) relevant for assessing whether total foreseeable demand is met by a combination of facilities? Staff note, section 76(3) of the QCA Act is explicit about having regard to expansion at the facility for the service and is silent about considering expansion at competing facilities. Stakeholders are encouraged to provide submissions, including legal opinions if necessary, if they consider expansion at competing facilities are relevant.

(23) How should the concept of 'satisfying foreseeable demand at least cost' be understood?

(24) Is the concept of differential pricing for expansions relevant to the QCA's assessment of 'at least cost'? If so, why and how?[30]

(25) If an expansion of the facility is necessary to satisfy foreseeable demand, how is 'least cost' assessed? For example, if the incremental costs of service provision at the facility for the service, following an expansion, are higher than at an alternative facility, but the average costs of service provision are lower, is the test of satisfying foreseeable demand at least cost satisfied? Please have regard to, and provide comment on, the example in Appendix B.

(26) What costs should be taken into account in determining the cost of satisfying foreseeable demand in a particular scenario? For example:

- (a) What costs (if any) associated with having multiple users at the facility should be considered?
- (b) Would the QCA be required to consider only the cost of using the facilities, or would it be required to also consider other costs necessarily incurred in accessing the service (e.g. additional transportation costs)? Staff's view is that ancillary costs are not relevant to assessing the concept of 'at least cost'. But those costs are relevant to determining whether services are in the same market. Staff invite submissions, including through legal opinions if necessary, to the extent that stakeholders have a contrary view.

[30] For example, the 2017 DBCT access undertaking provides for an 'incremental up, average down' approach to DBCT expansions, while recognising that each expansion will be assessed on a case-by-case basis. See Summary 11.30 of Queensland Competition Authority, *Final decision: DBCT Management's 2015 draft access undertaking*, November 2016, http://www.qca.org.au/getattachment/081401b3-903e-4aea-b9fd-9da8e544cf94/Secondary-Undertaking-Notice—Attachment—QCA-decisi.aspx.

4 CRITERION (A): ACCESS OR INCREASED ACCESS TO THE SERVICE ON REASONABLE TERMS AS A RESULT OF DECLARATION WOULD PROMOTE A MATERIAL INCREASE IN COMPETITION

Section 76(2)(a) of the QCA Act provides:

> that access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the service;

4.1 'As a result of declaration'

Criterion (a) requires a consideration of the impact of:

- access or increased access to the service, on reasonable terms and conditions as a result of declaration of the service
- on competition in at least one market (other than the market for the service).

The question is whether this would promote a material increase in competition in at least one other market, in which case criterion (a) is satisfied.

The starting point is the text of criterion (a). In this context, staff note that the words 'as a result of declaration' have not previously been included in criterion (a) under the Queensland or Commonwealth regime.

The Explanatory Memorandum for the Commonwealth's amendments to Part IIIA notes:

> [Criterion (a)] requires a comparison of two future scenarios: one in which the service is declared and more access is available on reasonable terms and conditions, and one in which no additional access is granted. That is a comparison of either: no access without declaration compared with some access as a result of declaration; or some access without declaration to additional access as a result of declaration. In comparing these two scenarios, it must either be the case that it is the declaration resulting in access (or increased access) on reasonable terms and conditions that promotes the material increase in competition.[31]

This is consistent with the approach to criterion (a) in the ACT's decision on the Sydney Airports matter, namely that:

> In order to determine whether access or increased access "would promote competition" in a dependent market, it is necessary to undertake an analysis of the future with declaration (which is referred to as the "factual") as against the future without declaration (which is referred to as the "counterfactual").[32]

Staff note the recent decision of the Full Federal Court in the Port of Newcastle matter[33] concluded that criterion (a) as considered in that case does not involve comparing a future with declaration and a future without declaration or taking into account existing and likely future usage. However, that decision was made in the context of different language of criterion (a) in Part IIIA of the CCA (that is, prior to the November 2017 amendments to the declaration criteria

[31] *Competition and Consumer Amendment (Competition Policy Review) Bill 2017*, Explanatory Memorandum, para 12.20.
[32] *Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [148].
[33] *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 at [138]-[139]

in the CCA). Specifically, the previous phrasing of criterion (a) did not contain the phrase 'as a result of declaration'.

Given the wording of criterion (a) in Part 5 of the QCA Act is consistent with the language of Part IIIA of the CCA, staff consider there is limited guidance available from the Full Federal Court's approach to criterion (a) in the Port of Newcastle decision. Rather, staff's preliminary view is that it could be appropriate to interpret criterion (a) by taking into account whether declaration would materially promote competition in a dependent market compared to a scenario in which the declaration did not continue.

The focus of criterion (a) would therefore be on whether access (or increased access) on reasonable terms, as a result of declaration, would promote a material increase in competition in dependent markets. In doing so, any assessment ought to consider the extent to which the service provider would have the ability and incentive to exert market power such that, in the absence of declaration, it could restrict access or unreasonably increase its access price, thereby impacting on competition in markets that are dependent on access to the service.

4.1.1 Relevance of existing arrangements

Part of staff's proposed approach is to examine whether there are any mechanisms or contractual arrangements which would operate to ensure access to the services, on reasonable terms, other than as a result of declaration, and the nature of those arrangements. Such mechanisms or arrangements could be relevant in any comparison of the future state of competition in a dependent market with and without the declaration.

For instance, staff note that there is presently access to each of the declared services in section 250(1) through access agreements that access holders have negotiated with the regulated service provider. These agreements have varying expiry dates and renewal profiles. Staff's preliminary view is that such access agreements would be relevant to the QCA's assessment if they would result in access being provided on reasonable terms, even if the declaration had expired.

Staff invite submissions on what existing arrangements that would apply during the regulatory period (if any) are relevant in assessing whether criterion (a) is satisfied; namely in respect of the potential impacts in dependent markets in the future if there was no declaration versus declaration.

Specifically, the assessment will be:

- whether there would be access or increased access, on reasonable terms, as a result of declaration compared to a future without declaration (including access or increased access provided through existing access agreements and any relevant other mechanisms, contracts or arrangements)
- whether this promotes a material increase in competition in at least one dependent market.

Staff's initial view is that it is appropriate to conduct this assessment on the basis that access terms approved under Part 5 of the QCA Act are reasonable terms (recognising that there may be other terms and conditions that could also be reasonable). Staff propose to therefore examine whether declaration under Part 5 of the QCA Act will promote a material increase in competition compared to a future in which the services are not declared and there is no access, or access not on reasonable terms and conditions, or access on reasonable terms and conditions other than as a result of declaration.

4.2 Dependent markets

Criterion (a) provides for promoting competition in at least one market other than the market for the service. Staff's preliminary view is that this criterion requires an evaluation of the boundaries of the market for the relevant service (on the basis set out above in relation to the definition of the relevant market in assessment of criterion (b)), and the identification of dependent markets and whether the dependent markets are separate from the market for the service. Once it is confirmed that dependent markets are separate, the proposed approach by staff is to consider whether access or increased access to the service as a result of declaration will result in a materially more competitive environment in the dependent market(s).

Staff's preliminary view is that it is not necessary to demonstrate that competition is enhanced. Rather, the relevant matter is whether the competitive environment is enhanced. In this regard, staff are proposing to consider guidance on the correct interpretation from the ACT's position on criterion (a) in its decision on Sydney International Airports as follows:

> The Tribunal does not consider that the notion of 'promoting' competition … requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of 'promoting' competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration. (at [106])
>
> …
>
> It is in this sense that the Tribunal considers that the promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. (at [107]) [34]

4.2.1 Ability and incentive to exercise market power

Staff are considering whether it is relevant to assess the extent to which the regulated entity has both the ability and incentive to exercise market power so as to affect competition in a dependent market in the absence of declaration.[35] Factors relevant to whether the regulated entity has an ability to exercise market power may include barriers to entry, the extent to which it is a natural monopoly and the existence of spare capacity (hence the relevance of the criterion (b) assessment). Market power may also result from the bottleneck position of the facility in the relevant supply chain. Likewise, factors relevant to the incentive for the regulated entity to exercise market power may include:

- the extent to which dependent market is competitive
- the market power of other participants in the relevant market. This reflects, at least in part, the extent to which other market participants can access substitutable services from alternative service providers
- vertical integration of the regulated service provider with other providers in the supply chain
- the incentives faced by the service provider to exert market power.[36]

[34] *Sydney International Airport* [2000] ACompT 1.
[35] NCC, *A guideline to declaration under Part IIIA of the Trade Practices Act 1974 (Cth)*, August 2009, at para 3.46. See also the ACT's decision *in Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [117].
[36] NCC, *A guideline to declaration under Part IIIA of the Trade Practices Act 1974 (Cth)*, August 2009, at paras 3.47 and 3.48; *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2 at [117].

4.3 Summary of approach to criterion (a)

Given the above considerations, in assessing whether criterion (a) is satisfied, QCA staff's preliminary view is that the following approach could apply:

(a) identify the relevant dependent (upstream or downstream) markets

(b) confirm that the relevant dependent market is separate from the market for the declared service in section 250 of the QCA Act

(c) assess whether access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration would promote a materially more competitive environment in the dependent markets, thereby promoting a material increase in competition. This would include assessment of arrangements for access, other than as a result of declaration.

Staff consultation questions – Criterion (a)

(1) Do you agree with staff's proposed interpretation of criterion (a)? If not, what do you consider is an appropriate approach to interpreting criterion (a)?

(2) Subject to the above question, what information and analysis in respect of the matters (a) to (c) in s. 4.3 above is relevant to assessing whether this criterion is satisfied for each declared service? In this context, staff are particularly interested in the following information.

<u>The relevant markets</u>

(3) What is the relevant market for the service described in section 250 of the QCA?

(4) What are the relevant dependent markets? In answering this, please explain:

- (a) The rationale for defining the relevant market for the service in the manner defined.
- (b) How the dependent markets are separate from the relevant market for the service.

<u>Existing access</u>

(5) What are the existing access arrangements for the services described in section 250? Are there arrangements which would ensure access or increased access, on reasonable terms, other than as a result of declaration? Factors may include the extent to which existing access agreements provide access or increased access.

Key factors that may be relevant could include:

- (a) Existing contract durations and renewal profiles, pricing mechanisms within contracts and whether they are linked to QCA-established prices as a result of declaration.
- (b) The extent to which there is current or foreseeable demand for the service and which is not the subject of existing contracts.
- (c) Contractual obligations to provide access or increased access (for example, under an access agreement).

<u>Market conditions in dependent markets</u>

(6) To what extent are the identified dependent markets competitive?

(7) What is the proportion of the total product price that is reflected by the existing access price? For instance, for the declared services of Aurizon Network and DBCT, this may represent the existing access price for the below rail or coal handling facility as the proportion of the free on board costs of export coal. (The proportion of the total product price that is reflected by the existing access price may be indicative of the likely effect of declaration or lack thereof in dependent markets).

(8) What are current and future anticipated market conditions in dependent markets?

<u>The additional impact of declaration in light of existing access</u>

(9) What empirical evidence or benchmarking data is available that can demonstrate whether declaration would result in a material increase in competition in dependent

markets? This may include evidence of sensitivity of upstream and downstream markets to price changes by the regulated service provider.

(10) What would be the impacts on dependent markets if the service was not declared?

(11) To what extent does a regulated service provider have an ability or incentive to exert market power so as to affect competition in a dependent market (e.g. by restricting access or unreasonably increasing the access price)?

(12) What level of vertical integration is there between the market for the declared service and any dependent markets presently, and what level of integration is anticipated going forward? What would be the effect of vertical integration on competition in dependent markets with/without declaration?

5 CRITERION (C): THE FACILITY IS OF STATE SIGNIFICANCE

Section 76(2)(c) of the QCA Act provides:

> that the facility for the service is significant, having regard to its size or its importance to the Queensland economy;

Staff consider that, among other things, the following considerations could be relevant to this criterion:

- size and capacity of the facility—including the physical capacity of the facility and its physical and geographic dimensions (including the size of its footprint and/or its start and end points)
- importance of the facility to the Queensland economy—including by reference to its contribution to exports, employment and GDP.

Staff note that these factors are consistent with the recent amendment to section 44CA of Part IIIA of the CCA.

Staff consultation questions – Criterion (c)

(1) Do you agree with the matters that staff consider could be relevant to assessing criterion (c)? If not, what do you consider is an appropriate approach to interpreting criterion (c)?

(2) Subject to the above question, are the declared facilities of state significance?

(3) Where possible, data should be provided to support any assertions.

6 CRITERION (D): ACCESS WOULD PROMOTE THE PUBLIC INTEREST

Section 76(2)(d) of the QCA Act provides:

> that access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration of the service would promote the public interest.

Section 76(5) furthers states:

> In considering the access criterion mentioned in subsection (2)(d), the authority and the Minister must have regard to the following matters—
>
> (a) if the facility for the service extends outside Queensland—
>
> (i) whether access to the service provided outside Queensland by means of the facility is regulated by another jurisdiction; and
>
> (ii) the desirability of consistency in regulating access to the service;
>
> (b) the effect that declaring the service would have on investment in—
>
> (i) facilities; and
>
> (ii) markets that depend on access to the service;
>
> (c) the administrative and compliance costs that would be incurred by the provider of the service if the service were declared;
>
> (d) any other matter the authority or Minister considers relevant.

Regarding s. 76(5), staff note that the explanatory memorandum for the Queensland amendments state that:

> While the new section 76(5) simplifies the range of matters the Authority and the Minister must have regard to when assessing the public interest criterion, under the new subsection (5)(d) the Authority or the Minister can still have regard to any of the matters that were previously listed in the existing section 76(3), if considered relevant.[37]

Staff note that criterion (d) constitutes an additional positive criterion that the QCA must be satisfied of. In other words, it is not sufficient to demonstrate that access is not contrary to the public interest. Rather, the QCA must be satisfied that access in the relevant sense would promote the public interest.

Staff's preliminary view is that criterion (d) accepts the findings of the application of the other criteria, but it enquires whether, on balance, declaration would promote the public interest. The matters that the QCA must have regard to are specified in section 76(5) of the QCA Act.

As part of the assessment, staff considers that regard could be had to the extent to which, if at all, declaration may impact on investment and incentives to invest in:

- the regulated facility
- dependent markets, including facilities that are located in upstream and downstream markets and whose operation is dependent (at least in part) on obtaining access to the regulated facility.

[37] *Queensland Competition Authority Amendment Bill 2018* (Qld), Explanatory Memorandum, at p. 6

Staff also note that the QCA must have regard to the administrative and compliance costs that would be incurred by the service provider if the service was declared (s. 76(5)(c)). Staff's preliminary view is that regard could also be had to the extent to which, if any, there are countervailing benefits to access seekers, including in terms of reduced compliance and administration costs associated with seeking access to a declared facility (s. 76(5)(d)).

Staff questions – Criterion (d)

(1) Do you agree with the matters that staff consider could be relevant to assessing criterion (d)? If not, what do you consider is an appropriate approach to interpreting criterion (d)?

(2) Does declaration provide benefits for access seekers and holders (including in terms of investment certainty and reduced administration/compliance costs)? Please provide evidence and data on these matters to support your views.

(3) Does declaration impose costs on the access provider (including in terms of investment uncertainty and administrative/compliance costs)? Does declaration create a disincentive to invest? If so, how does that occur, given that access or increased access as a result of declaration must be on reasonable terms? Please provide evidence and data on these matters to support your views.

(4) If the second and third points above hold true, how should the QCA weigh these balancing considerations? What factors will be relevant to forming a view on this matter?

(5) Criterion (d) enables to the QCA to have regard to 'any other matter the authority … considers relevant'. What specific matters are relevant in this respect?

APPENDIX A: DEFINING THE MARKET FOR THE PURPOSE OF CRITERION B

MinterEllison

3 April 2018

Mr Ravi Prasad
Queensland Competition Authority
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BRISBANE QLD 4001

By email: ravi.prasad@qca.org.au

Dear Mr Prasad

Defining 'the market' for the purpose of criterion (b) under the *Queensland Competition Authority Act 1997*

1. Instructions

We are asked to advise on the following questions:

In the context of making a recommendation as to whether a service should be declared under Part 5 of the QCA Act:

1. *What is the correct approach to defining the relevant market for the purpose of determining whether criterion (b) (as amended) is satisfied?*
2. *In defining the relevant market, what consideration should be given to other facilities which may be capable of performing the same function as the facility for the service, but which may not be readily available to customers due to, for example, distance, or because access to the facility has not been offered?*

2. Background

2.1 Section 87A of the *Queensland Competition Authority Act 1997* (**QCA Act**) requires the QCA to make a recommendation on whether three services, which are currently declared for the purpose of Part 5 of the QCA Act, should continue to be declared following the expiry of the existing declarations.[1] The QCA will start considering its recommendations in 2018, with recommendations to be given to the responsible Minister between 8 September 2019 and 8 March 2020.[2]

2.2 In deciding whether or not a service should continue to be declared, section 87C requires the QCA to determine whether it is satisfied about each of the access criteria for the service. The access criteria, which are to be found in section 76 of the QCA Act, have recently been amended to align them more closely to the declaration criteria in Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**).[3]

[1] The three services in question are those declared by virtue of the provisions in Part 12 of the QCA Act.

[2] The declarations expire on 8 September 2020. The timing of the QCA's recommendation for each service is governed by section 87A(1) of the QCA Act.

[3] *Queensland Competition Authority Amendment Act 2018*, section 4.

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2.3 We are asked to advise on the correct approach to market definition in the application of criterion (b) in section 76 of the QCA Act, which now reads as follows:

> *'that the facility for the service could meet the total foreseeable demand in the market-*
>
> *(i) over the period for which the service would be declared; and*
>
> *(ii) at the least cost compared to any 2 or more facilities (which could include the facility for the service)'.*

3. What is the correct approach to defining the relevant market for the purpose of determining whether criterion (b) (as amended) is satisfied?

3.1 We start by considering the purpose of market definition in the context of criterion (b). The criterion requires the QCA to consider whether the facility for the service could meet the total foreseeable demand 'in the market' at least cost. Clearly the application of this criterion requires the QCA to identify the relevant market.

3.2 In this case, we consider that criterion (b) requires the QCA to identify the market in which the declared service is supplied. While the criterion refers to the 'facility for the service' the declared service is, in each case, described as the use of a facility for certain purposes. We consider that criterion (b) requires the QCA to consider whether the relevant facility can meet total foreseeable demand, in the market in which the declared service is supplied, at least cost. It follows that the relevant market is the market in which the declared service is provided.

3.3 The starting point in defining the relevant market for the purpose of criterion (b) is section 71(2) of the QCA Act, which states:

> *'If **market** is used in relation to goods or services, it includes a market for—*
>
> *(a) the goods or services; and*
>
> *(b) other goods or services that are able to be substituted for, or are otherwise competitive with, the goods or services mentioned in paragraph (a).'*

3.4 The reference to substitutes is consistent with the principles articulated by the Trade Practices Tribunal in *Re Queensland Co-operative Milling Association* (1976) ATPR ¶40-012 (**QCMA**):

> *'Within the bounds of a market there is substitution — substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another. As well, on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives.*
>
> *It is the possibilities of such substitution which set the limits upon a firm's ability to "give less and charge more". Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to "give less and charge more" would there be, to put the matter colloquially, much of a reaction? And if so, from whom? In the language of economics the question is this: From which products and which activities could we expect a relatively high demand or supply response to price change, i.e. a relatively high cross-elasticity of demand or cross-elasticity of supply?'*

3.5 Section 71(2) of the QCA Act refers not only to services that are able to be substituted for the declared service, but also to services that are 'otherwise competitive with' the declared service. A similar reference is to be found in section 4E of the CCA.

3.6 Courts have taken different views of the significance of the words 'otherwise competitive with', in section 4E of the CCA. In *News Limited v Australian Rugby Football League Ltd* (1995) 58 FCR 447, Burchett J (at p 478) held that the inclusion of these words reflected a legislative intention to specify wider rather than narrower markets. Such an approach would suggest that goods and services could be in the same market, even where they are not close substitutes.

3.7 However, this approach was not followed by the Federal Court in the later decision of *Australian Rugby Union Ltd v Hospitality Group Pty Ltd* (2000) 173 ALR 702, and was not endorsed by Professor Corones, who has expressed the view that the words 'otherwise competitive with' in section 4E of the CCA, should be regarded as no more than a synonym for 'substitutable'.[4]

3.8 In *Seven Network Limited v News Limited* [2009] FCAFC 166, Dowsett and Lander JJ (with whom Mansfield J agreed) stated (at [621]):

> *'In the present case the parties do not submit that the words "or otherwise competitive with" should be construed as significantly undermining the principle of substitutability. The better view is that s 4E addresses constraints upon the supply or acquisition of the relevant goods or services. In that context the word "substitutable" is used in a narrow sense whilst the words "or otherwise competitive with" include degrees of "substitutability". We accept that the section addresses "close" competition and that "closeness" is a matter of degree.'*

3.9 We consider it appropriate to apply the same approach to understanding section 71(2) of the QCA Act. Taking this approach, it is clear that the definition of the relevant market for the purpose of applying criterion (b) requires the identification of those services which are close substitutes for the relevant declared service. A similar approach has been taken by the Australian Competition Tribunal in past decisions relating to the declaration of services under Part IIIA of the CCA.[5]

3.10 The question then turns to the methods by which close substitutes can be identified. The Australian Competition Tribunal in *Re Fortescue Metals Group Limited* [2010] ACompT 2 (**Fortescue**) canvassed, at [1018]-[1034], a number of methods that could be used:[6]

(a) Reasonable interchangeability of use

This approach entails a study of actual and potential buyer and seller substitution patterns to determine the cross-elasticity of demand and/or supply, with high cross-elasticity of demand or supply indicating that the products are close substitutes.

(b) Shipment flows (also described by the Tribunal as the 'Elzinga-Hogarty' approach)

Under this approach the geographic market is the smallest insular region into which few products have come from the outside and from which few shipments go outside.

(c) Hypothetical monopolist test

Under this approach, the market is defined as a group of products and a corresponding geographic area within which a hypothetical monopolist would be able to raise prices profitably. The Tribunal noted that this method had become increasingly popular, and

[4] Corones S G, *Competition Law in Australia*, (5th ed), page 69.

[5] eg. *Re Fortescue Metals Group Limited* [2010] ACompT 2 at [1013]; *Re Services Sydney Pty Ltd* [2005] ACompT 7 at [122].

[6] While this decision was set aside on appeal, this part of the Tribunal's decision was not addressed by the Full Federal Court.

had been adopted, in different forms, in merger guidelines published the US Department of Justice and the ACCC.

3.11 In *ACCC v Metcash Trading Limited* [2011] FCAFC 151 (**Metcash**), Yates J (with whom Finn J agreed) described the hypothetical monopolist test in the following terms at [247]:

> *'One tool that is used to provide an analytical framework to identify and evaluate substitution possibilities is the "SSNIP test", also referred to in the present case as "the hypothetical monopolist test" (a description which I will use in these reasons). This test involves determining whether a hypothetical monopolist supplier could profitably impose a small but significant non-transitory increase in price (most commonly, but not necessarily, between 5 and 10%) for the supply of a relevant product. Starting with the firm and product in issue, the market boundaries are expanded to include all sources of close substitutes that would defeat the increase. The smallest area, generally in terms of product identification and geographic space, over which the hypothetical monopolist can profitably impose the increase, shows the boundaries of the market.'*

3.12 The QCA Act does not dictate that any particular approach to market definition be used in preference to, or to the exclusion of, any other method. Whether a particular method may be suitable, and the weight given to the analysis, is a decision for the QCA. The choice of method could vary depending on such matters as the availability of data or the QCA's assessment of the reliability of each method in this particular case. Nevertheless, the hypothetical monopolist test has been widely utilised by Australian courts and remains a key tool used by the ACCC under its merger guidelines. Stakeholders may expect that such an approach would feature (possibly alongside others) in the QCA's consideration of the relevant markets for the purpose of deciding whether services should continue to be declared.

3.13 In applying a 'hypothetical monopolist test' for the purpose of market definition, it is also important to be mindful of the comments of Yates J in Metcash:

> *'[248] The hypothetical monopolist test is predicated on the availability of data on variables, such as costs, prices, revenue and sales, over a sufficiently long period of time to enable a mathematical determination to be made about how changes by a firm to its prices affect its own demand. In competition law, however, the test is not always applied in that way. Sometimes it is applied without data as a "thought experiment" to make a qualitative assessment about the product and geographic dimensions of the market: Seven Network Limited v News Limited [2007] FCA 1062 at [1786]. Indeed, paragraph 4.22 of the Commission's own Merger Guidelines promotes and justifies such an approach:*
>
> > *While the [hypothetical monopolist test] is a useful tool for analysis, it is rarely strictly applied to factual circumstances in a merger review because of its onerous data requirement. Consequently, [the Commission] will generally take a qualitative approach to market definition, using the [hypothetical monopolies test] as an "intellectual aid to focus the exercise".*
>
> *[249] It is apparent that, when the hypothetical monopolist test is applied in this fashion, conclusions can be reached about the boundaries of a market on which reasonable minds might differ. It follows from this realisation that a difference in opinion in the identification of market boundaries does not necessarily signify the presence of error in the evaluative process.*
>
> *[250] It is also apparent that, when the test is applied in this fashion, considerations other than price (the ability to "give less") can be accommodated in the evaluative process.'*

3.14 While a hypothetical monopolist test may be a suitable tool for defining the relevant markets for the purpose of applying criterion (b), this test should not be applied in an overly rigid or restrictive manner. The views of interested parties, as well as the QCA's own deliberations,

will be relevant in deciding what methods will be used as part of the market definition exercise, and how these methods can and should be applied with respect to each of the declared services for which the QCA must make a recommendation.

4. In defining the relevant market, what consideration should be given to other facilities which may be capable of performing the same function as the facility for the service, but which may not be readily available to customers due to, for example, distance, or because access to the facility has not been offered?

4.1 As noted above, the definition of the relevant market requires consideration of the declared service and those other services which are close substitutes. Whether distance will result in another service being in a different market will depend on whether that distance (and the associated costs of switching) are such that customers would not be prepared to switch in response to a sufficient price incentive (put another way, whether a hypothetical monopolist could profitably impose a SSNIP without losing customers to the alternative supplier). In this context, it is important to recognise that market definition is not an exact science, and drawing the geographic boundary of a market is often a matter of degree.

4.2 The analysis is more complicated if there is another facility which can perform the same (or a similar function) but which is not offered to customers. Such a facility might be viewed as a potential substitute, but is it a sufficiently close substitute to be placed in the same market?

4.3 In *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177 (**Queensland Wire**), Deane J stated (at page 196):

> *'While actual competition must exist and be assessed in the context of a market, a market can exist if there be the potential for close competition even though none in fact exists. A market will continue to exist even though dealings in it be temporarily dormant or suspended. Indeed, for the purposes of the Act, a market may exist for particular existing goods at a particular level if there exists a demand for (and the potential for competition between traders in) such goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time - because, for example, one party is unwilling to enter any transaction at the price or on the conditions set by the other.'* [7]

4.4 We see no inconsistency between this passage and the approach to market definition outlined in QCMA (see above). In QCMA, the Tribunal described a market as *'the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive'*.

4.5 Applying this approach, the fact that there is no history of switching between two facilities does not necessarily mean that such switching would not occur, over the long run, in response to price or other incentives. Various considerations could explain an absence of transactions in a market, without precluding the possibility of substitution in the future. Equally, if there are reasons to conclude that, even over the long run, customers would be unlikely to switch in response to price incentives, the approach outlined in QCMA would support the conclusion that the services are offered in separate markets. The principle articulated by Deane J in the passage from Queensland Wire (above) does not preclude such a finding. Rather, it calls for an inquiry into the reasons why there have been no transactions, and the implications of those findings for the possibility of substitution in the future.

4.6 It follows that, in a situation where the QCA identifies a facility which is functionally similar, but to which third party access has not been offered, it is necessary to inquire into why this is so, and what is likely to happen in the future. If, for example, the absence of access is attributable

[7] This passage was cited with approval in *NT Power Generation Pty Ltd v Power and Water Authority* [2004] HCA 48 at [109].

to commercial considerations which might change over the long term (thereby creating the conditions for substitution in response to price or other incentives) it may follow that the facilities operate in the same market. Conversely, if the absence of access is due to other considerations, which reflect the characteristics of the relevant facility and which are unlikely to permit substitution even over the long term, it may follow that the facilities are operated in separate markets.

4.7 The QCA's task can be illustrated by reference to the handling of coal through the Dalrymple Bay Coal Terminal (**DBCT**), one of the declared services which will be the subject of the QCA's inquiry. The facility for the declared service is the coal export terminal at the Port of Hay Point operated by DBCT Management Pty Ltd. This is one of two facilities at the Port of Hay Point used for the handling of coal for export, the other being the Hay Point Coal Terminal (**HPCT**) which is operated by the BHP Billiton / Mitsubishi Alliance (**BMA**).

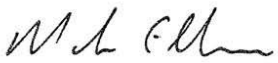
4.8 One of the questions that will arise in defining the relevant market for the purpose applying criterion (b) to this declared service is whether the handling of coal at DBCT and HPCT are services which are provided in the same market. A fact that would be relevant to this analysis is if HPCT is used only by BMA. While both DBCT and HPCT are used for the export of coal through the Port of Hay Point, HPCT is not declared and access has not, historically, been offered to third party customers.

4.9 As outlined above, the absence of third party access does not necessarily mean that the services are provided in separate markets. The question remains whether there is, or would be, a sufficient likelihood of substitution between the two facilities in response to price or other incentives in the future?

4.10 If there has been no third party access in the past, the market definition exercise calls for an inquiry into why this is so, and what this means for the possibility of substitution between the two facilities in the future. For example, is the absence of third party access to HPCT a consequence of transactions being 'temporarily' dormant, or is this a situation that is likely to endure? Is there reason to believe that BMA has (or would) switch demand between HPCT and DBCT in response to movements in the relative cost of the two facilities? Again, the answers to these questions will depend heavily on the submissions of interested parties and the QCA's consideration of all of the information before it.

Please do not hesitate to contact us if you wish to discuss these matters in further detail.

Yours faithfully
MinterEllison



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APPENDIX B: APPLYING CRITERION B

Hypothetical worked example—simplified illustration of possible application of criterion (b)

Declared service

The declared service is ‘the use of the widget processing facility provided at V’.

The market

V operates in 'the market for processing widgets within approximately 100 km of V'. This is because users up to 100 km away use, or have previously used, V to process widgets.

Assessment period and market demand

The QCA determines that the declaration period is 10 years, given pending changes to the market structure. Foreseeable market demand for the service is therefore assessed over a 10-year period.

Over a 10-year declaration period, total foreseeable demand in the market for the service provided by V is 200 widgets per year. This reflects total foreseeable demand for the use of widget processing facilities within 100 km of V from users.

The criterion (b) assessment is whether V in existing or expanded form could meet total foreseeable demand of processing 200 widgets per year at least cost compared to any two or more facilities that can also satisfy this demand.

Criterion (b) is only satisfied where V by itself, in either existing or expanded form, can satisfy total foreseeable demand at least cost.

Facility V

V presently processes 180 widgets at $1 per widget. V can be expanded to process an extra 20 widgets. The incremental expansion cost for the additional 20 widgets is $1.20 per widget.

The cost of V meeting total market demand is:

$$\frac{(180 \times \$1.00\ per\ widget) + (20 \times \$1.20\ per\ widget)}{200\ widgets} = \$1.02\ per\ widget$$

This reflects the average cost at Facility V to process widgets, assuming it is expanded to the extent necessary to meet total foreseeable demand in the market.

Facility W

Facility W is the only facility that operates within 100 km of V. It processes 20 widgets at $1.10 per widget, which represents the unit cost of W partially contributing to meeting total market demand of 200 widgets per year.

Conclusion

In non-expanded form, Facility V is the cheapest processor of widgets at $1/widget, compared to Facility W whose cost is $1.10/widget. However, without expansion, Facility V is unable to meet total foreseeable demand in the market.

Facility V can be expanded to process additional widgets at an incremental cost of $1.20/widget.

Facility V's average cost to satisfy total foreseeable demand is $1.02/widget (assuming it is expanded). The question is whether the total demand can be met at a lower cost using 2 or more facilities. In this scenario, the combination of facilities that can satisfy total foreseeable demand at least cost is:

- Facility V in existing form – 180 widgets at $1/widget
- Facility W in existing form – 20 widgets at $1.10/widget

The average cost to meet demand for processing widgets is then:

$$\frac{(180 \times \$1.00\ per\ widget) + (20 \times \$1.10\ per\ widget)}{200\ widgets} = \$1.01\ per\ widget$$

As the incremental expansion cost (on a per widget basis) at Facility V is greater than the existing cost (on a per widget basis) of using Facility W, an expanded Facility V cannot satisfy total foreseeable demand at a lower cost than the two existing facilities.

Criterion (b) is not satisfied.