



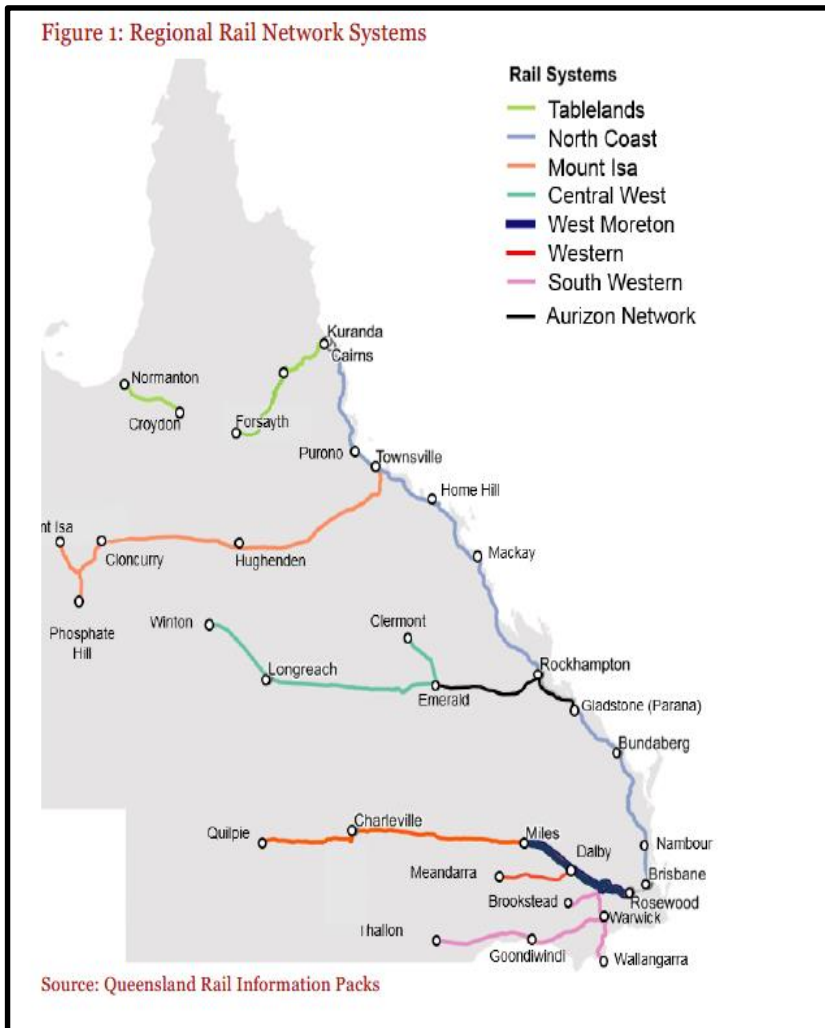
QCA'S DECLARATION REVIEW PUBLIC FORUM : QUEENSLAND RAIL

9 APRIL 2019

OUTLINE OF PRESENTATION

- Context: Queensland Rail's business
- Object of Declaration and Regulated Access
- Summary of Queensland Rail's Position on Access Criteria
- Criterion (a)
 - The Access Framework means there will be no difference in market outcomes with or without declaration and so criterion (a) cannot be satisfied
 - Even without the Access Framework, criterion (a) is clearly not satisfied for all services other than the West Moreton high-tonnage scenario
 - Queensland Rail's cost recovery challenges show it has no ability or incentive to raise prices
 - Market and other constraints will continue to bind Queensland Rail with or without declaration
 - 'Second-period hold-up problem' does not arise
- Criteria (b), (c) and (d)

CONTEXT: QUEENSLAND RAIL'S BUSINESS



- Queensland Rail is in a unique position.
 1. Statutory authority
 2. Commercially viable only with substantial payments under the Rail Transport Services Contract (TSC) with Queensland government

CONTEXT: STATE OF THE BUSINESS [BELOW-RAIL]

	West Moreton Region	Mount Isa Region	North Coast Region	Metropolitan	Western	South-Western	Central-Western	Tablelands	Total
REVENUE ('000)									
Access Charges- Coal	42,752			19,270					62,022
Access Charges - Other	2,467	74,301	46,374	124,726	893	389	998	4,163	254,313
TSC Revenue	743		152,339	311,015	16,967	21,385	48,878	15,390	566,714
Other Revenue	1,147	1,300	3,332	4,913	285	228	703	190	11,809
Total Revenue	47,109	75,601	202,045	459,925	18,145	22,001	50,578	19,743	895,146
OPERATING EXPENSES ('000)									
Total Operating Expenses (including depreciation)	42,432	59,348	144,700	328,097	15,805	19,378	41,155	17,924	669,099
Earnings Before Interest and Tax (EBIT)	4,677	16,253	57,345	131,828	2,340	2,623	9,423	1,819	226,047
Earnings Before Interest, Tax and TSC Revenue	3,934	16,253	(94,995)	(179,188)	(14,628)	(18,762)	(39,455)	(13,571)	(340,667)

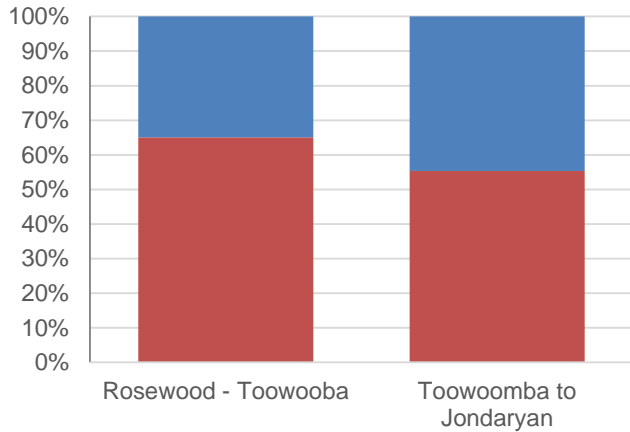
(<https://www.queenslandrail.com.au/business/access/Compliance%20and%20reporting/2017-18%20Below%20Rail%20Financial%20Statements.pdf#search=below%20rail%20financial%202017-18>).

*Supplemented with disaggregated Queensland Rail data for Metropolitan, Western, South-Western, Central Western and Tablelands

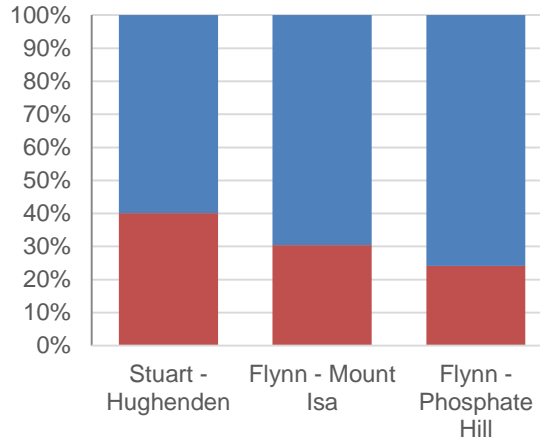
CONTEXT: SIGNIFICANT SPARE CAPACITY

Available
Used

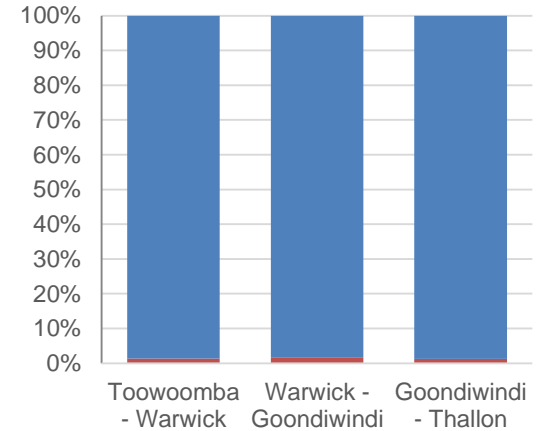
West Moreton System 2017-18 Utilisation



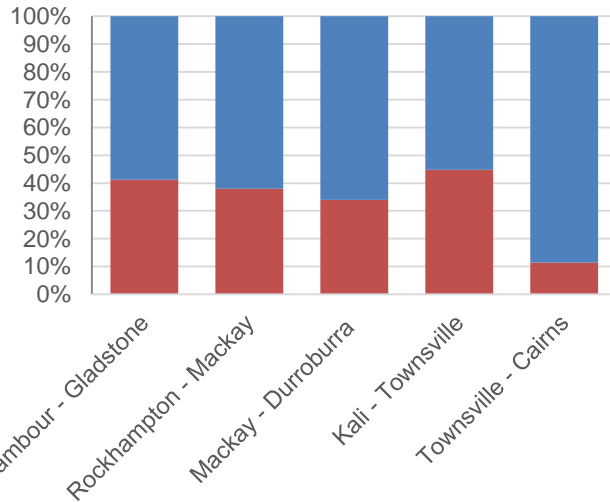
Mount Isa Line 2017-18 Utilisation



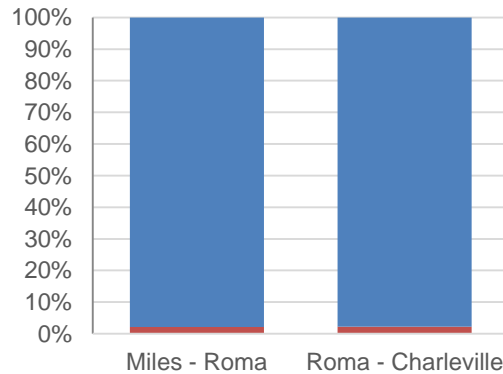
South Western System 2017-18 Utilisation



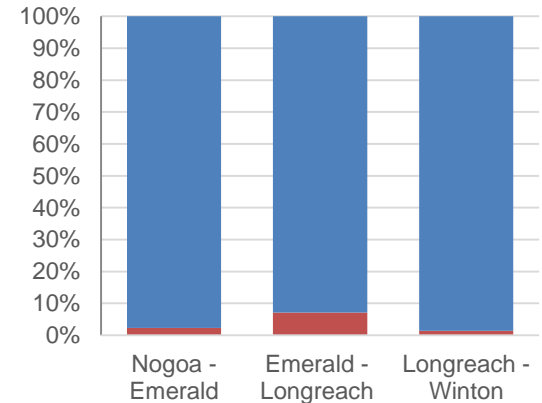
North Coast Line 2017-18 Utilisation



Western System 2017-18 Utilisation











Central Western System 2017-18 Utilisation



CONTEXT: CHANGES TO RAIL INDUSTRY

- QCA Declaration Review is the first opportunity to apply access criteria to services provided by Queensland Rail.
- Fundamental changes to rail industry since the services were first declared by regulation mean they should no longer be declared.
 1. Structural changes – no relevant vertical integration
 2. Intensifying competition from road operators for non-coal traffic

Queensland Rail Freight Market Structure		
	Pre-structural separation	Current market structure
Below-rail		 
Above-rail	 	  

OBJECT OF DECLARATION AND REGULATED ACCESS

- Object of the regime is to '*promote the economically efficient operation of, use of, and investment in significant infrastructure with the **effect of promoting effective competition in upstream and downstream markets.***'
- Misuse of market power is the mischief. Promotion of competition is the objective.
- Queensland Rail has no market power. It does not (and cannot) earn super-normal profits with or without declaration.
- Queensland Rail has strong incentives to promote competition in freight markets.
- There is no potential harm to **competition** to justify declaration of Queensland Rail's services.

SUMMARY OF QUEENSLAND RAIL'S POSITION

	Criterion (a) (without Access Framework)	Criterion (a) (with Access Framework)	Criterion (b)	Criterion (c)	Criterion (d)
North Coast Line	✗	✗	✗	✓	✗
Mount Isa Line	✗	✗	✗	✓	✗
West Moreton (and Metropolitan)	✗*	✗	✗	✗	✗
South Western	✗	✗	✗	✗	✗
Western	✗	✗	✗	✗	✗
Central Western	✗	✗	✗	✗	✗
Tablelands	✗	✗	✗	✗	✗
Metropolitan	✗	✗	✗	✓	✗

CRITERION (A) OVERVIEW

- The Access Framework means there will be no difference in market outcomes in the future with or without declaration and thus criterion (a) cannot be satisfied.
- Even if the Access Framework is not taken into account:
 - Queensland Rail's cost recovery challenges show it has no ability and incentive to raise prices
 - Market constraints do and will continue to bind Queensland Rail with or without declaration.
- Second-period hold-up problem does not arise.

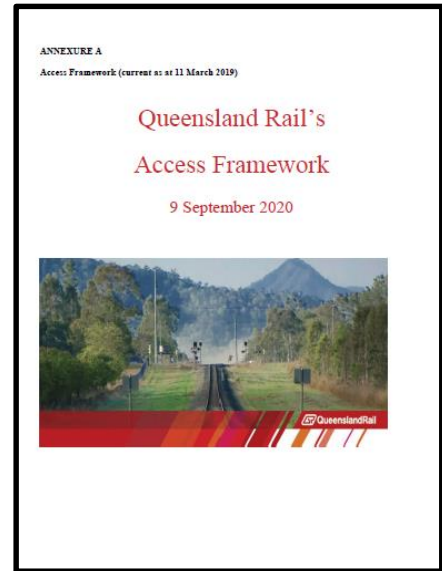
ACCESS FRAMEWORK AS A CONSTRAINT

- Queensland Rail has put in place a legally binding Access Framework to preserve regulatory certainty in the future without declaration.
- The Framework retains key user protections from the 2016 AU and implements procedural and administrative changes to improve the operational efficiency of the regime.
- The Access Framework thus means there will be no difference in market outcomes in the future with or without declaration.
- Thus there can be no promotion of competition as a result of declaration.



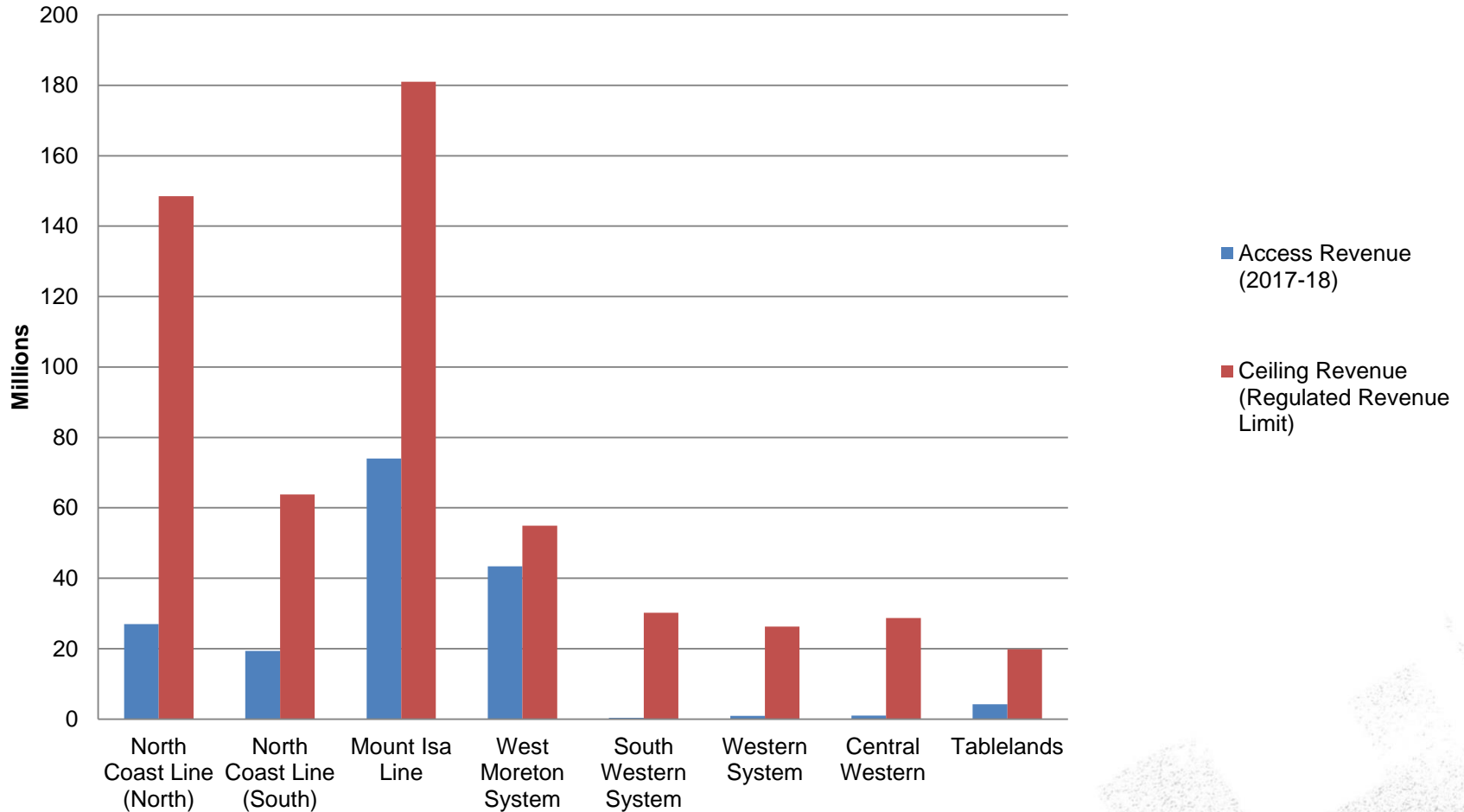
ACCESS FRAMEWORK AS A CONSTRAINT (CONT)

- The Access Framework is enforceable.
- Queensland Rail's ability to amend the Access Framework in limited circumstances is appropriate.
 1. The Access Framework provides the framework for negotiation / arbitration. It does not set access prices / revenues.
 2. The concept of an 'optimal' outcome in these circumstances is misplaced and is, in any event, subjective.



ACCESS REVENUE BELOW EFFICIENT COSTS

Access Revenues and Ceiling Revenue Limits (2017/18)

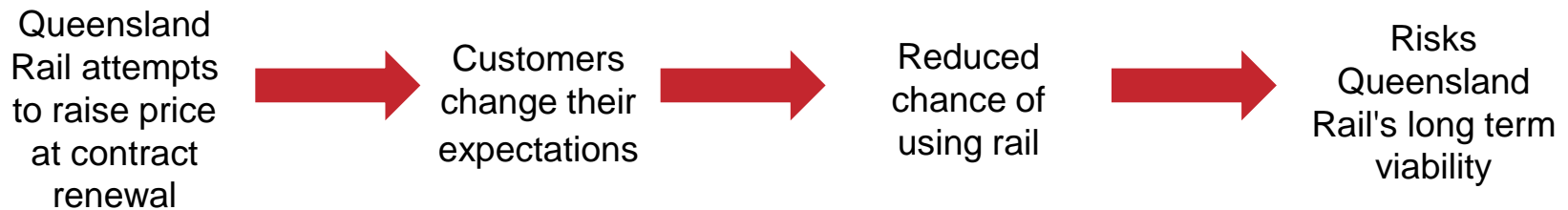


* Under the reference tariff arrangements, access revenue for coal traffic on the West Moreton System is intended to be at the revenue ceiling limit. There is a shortfall on the system as a whole, however, given the access revenue for non-coal traffic is well below the revenue ceiling limit.

* Data sourced from Figure 3.1 of the HoustonKemp Expert Report at page 9.

NO SECOND-PERIOD HOLD-UP PROBLEM

- Second-period hold-up problem does not arise
- Mutual incentives to contract around specific investment risks
- QR has multiple rounds of negotiations with all customers, with around 30 access agreements expiring at different times.



- In any case, current regulatory arrangements do not prevent 'second-period hold-up' since revenue is significantly below ceiling limits

LINE BY LINE ASSESSMENT

	Incentive to change price	Second-period hold-up problem	Competition in dependent market
North Coast System	Regulatory price controls are not binding – without declaration, Queensland Rail still has no ability to raise prices	Queensland Rail has no incentive to hold-up customers by raising 'second round' prices	No material change in prices or terms of access No material change in competition in any dependent market
Mount Isa System		Agreements are offered for all circumstances	
West Moreton System – low tonnes scenario		Current regulatory arrangements do not prevent second-round, hold-up	
West Moreton System – high tonnes scenario		Access framework constrains pricing power – without declaration, there still can be no change in prices	

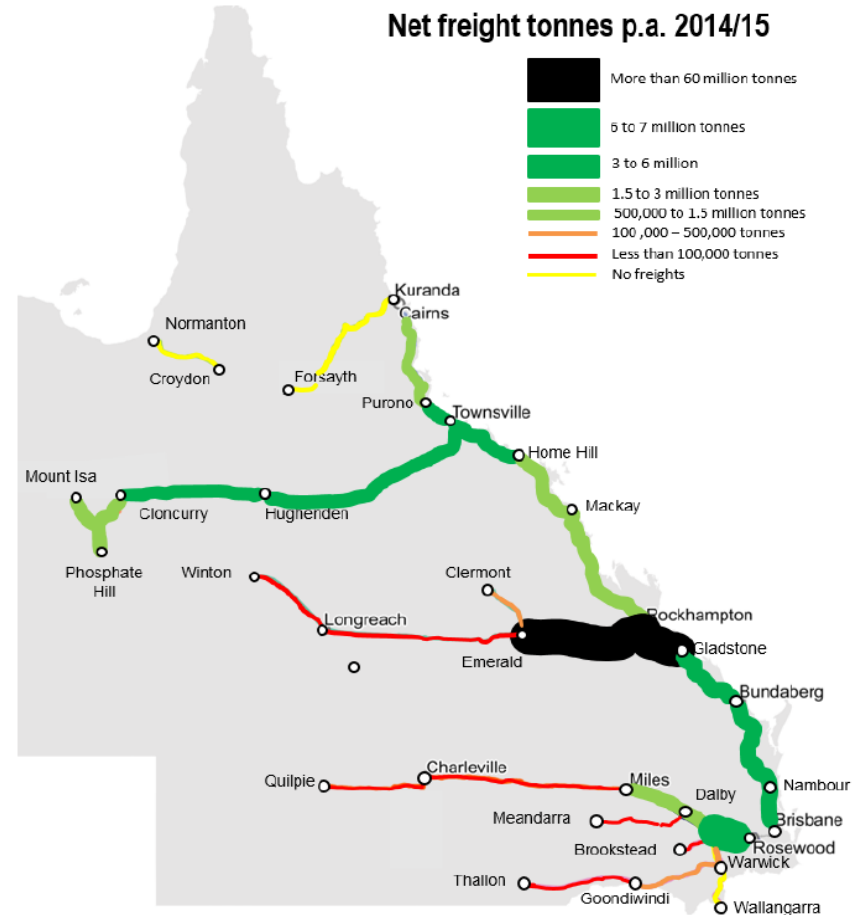
CRITERION (B)

- Foreseeable market demand dependent on customers' ability and incentive to use available substitutes
 - many customers would shift if rail access prices increase
- Substitutability must be correctly assessed
 - reference point is the workably competitive market price – not subsidised, below market access charges
 - need to avoid the 'reverse cellophane fallacy' – defining an overly narrow market through use of an artificial price
 - degree of substitutability between road and rail is underestimated

CRITERION (C)

- State significance must be assessed with regard to 'size' or 'importance to the Queensland economy'.
- Size is more than the length of a particular railway track.
- Due to the low volume/value of freight traffic, the 'Other Systems' are not 'significant infrastructure' within the meaning required of access criterion (c) (March Submission [355], [365], [374], [384]).

Figure 6: Freight net tonnages across the RRN in 2014/15



Source: PWC/Ranbury analysis of QR supplied network operations data

*Sourced from PwC Freight Logistics Chains Paper, August 2016, page 1

CRITERION (C): WEST MORETON SYSTEM

- West Moreton is not of sufficient size and importance to be of state significance.
- West Moreton is significantly shorter than the Herbert River Cane railway and is dwarfed in operational scale by the CQCN.
- It hauls 3% of Queensland's annual coal exports.

	Length	Access Revenue	Users	Throughput
Herbert River Cane Railway	530 km		575 growers	
West Moreton System	314 km	\$43m (2017-2018)	5 mines	7mtpa
Central Queensland Coal Network	2725 km	\$1170m (2017-18)	50+ mines	220mtpa

*Sourced from March Submission at [330], [335]-[339].

CRITERION (D): DECLARATION DOES NOT PROMOTE THE PUBLIC INTEREST

Declaration of any of Queensland Rail's services does not promote the public interest (March Submission at [391])

- There is no change in the environment and opportunities for investment in entry/expansion with or without declaration (March Submission at [405]-[409]).
- Declaration is associated with regulatory and compliance costs (March Submission at [424]-[433]).
- The Access Framework is in the public interest. It is appropriate, cost effective, and efficient. (March Submission at [434]-[442], HoustonKemp Report, section 5).

ADDITIONAL REFERENCES FOR ROAD V RAIL

- Queensland Rail March Submission at [134]-[151], [161]-[168]
- HoustonKemp Report, section 4.1.2 (Mount Isa Line) and section 4.2.2 (North Coast Line).
- Attachment C, Ranbury Report 'North Coast Line Capacity Improvement Study- Final report for the DMTR', February 2015, pp. 10-11, 48, 72, 86-88, 104-105, 147-150.
- Attachment D, PwC Queensland Regional Rail Network Review, Freight Logistics Chains Working Paper, August 2016, pp. ii, 5-7, 12-13, 14, 17-19, 19-22, 23-27, 28-30, 30-35.

