QUEENSLAND resources COUNCIL

QRC submission – CQCN

QCA Declaration Review

Submissions on Submissions

16 July 2018

QUEENSLAND resources COUNCIL

Resourcing Queensland's future

16 July 2018

Mr Charles Millsteed
Chief Executive Officer
Queensland Competition Authority
Level 27, 145 Ann Street
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(submitted via QCA online submission form)

Dear Mr Millsteed Charles

The Queensland Resources Council (**QRC**) provides this submission on behalf of our Rail Working Group members to the Queensland Competition Authority (**QCA**) on its staff issues paper on the re-declaration of declared services in Queensland.

The QRC confirms this submission may be made public.

As our submission makes clear, the QRC submits that use of the Central Queensland Coal Network satisfies the access criteria set out in the *Queensland Competition Authority Act 1997 (Qld)*. On that basis, the QCA should recommend that the currently declared service be re-declared for a minimum of 15 years.

Thank you for the opportunity to provide a submission. If you have any questions about this submission, please contact Andrew Barger at QRC on 3316 2502 or andrewb@qrc.org.au.

Yours sincerely

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1 Overview

The Queensland Resources Council (**QRC**) welcomes the opportunity to comment on submissions made in response to the Queensland Competition Authority's (**QCA**) staff issues paper (**First Issues Paper**) and provide a submission in response to the QCA's further staff issues paper (**Second Issues Paper**). This submission relates to the review of the declaration of the service for the use of a coal system for providing transportation by rail (**Service**) and is therefore primarily in response to the submission made by Aurizon.[1] However, where relevant, this submission does also address arguments or evidence presented by other parties.

Having considered the submissions made by other stakeholders, the QRC submits that the legal, economic and factual analysis presented by stakeholders does not alter the QRC's submission that the QCA should recommend declaration of the CQCN. In particular, of those submissions that appropriately and accurately examine the relevant authorities, none undermine the clear decision-making framework and conclusions proposed by the QRC (and further supported by the QRC's expert and counsel reports).

The QRC submits that Aurizon has not properly engaged with the declaration review process, instead making a submission that criticises the QCA and the existing regulatory regime while putting forward a range of irrelevant or incorrect considerations.

In particular, Aurizon only briefly considers criteria (a), (b) and (c) (and not in a useful or substantive way) and instead focuses on criterion (d), but in doing so:

- misapplies and overstates the relevant legal test that the QCA is required to apply in relation to criterion (d) – see section 5.2 below and paragraphs [10] to [16] of the Second Counsel Opinion (Attachment 1);
- underplays the obvious ability and incentive Aurizon will have to discriminate against competing above-rail suppliers absent declaration, along with the significant impacts that such discrimination will have (i.e. destroying competition in the above-rail market and damaging other dependent markets) – see section 5.3 below and paragraphs [4] to [10] of the Second RBB Expert Report (Attachment 2); and
- focuses on unsubstantiated public 'detriments' alleged to be suffered as a result of declaration, which are in any event ultimately borne by industry (who, as is clear from the QRC's submission, support declaration) – see section 3.1 below.

The QRC submits that Aurizon's failure to develop a compelling submission is indicative of the weight of evidence and authorities that undermine Aurizon's cause (i.e. the relevant materials overwhelmingly support a recommendation by the QCA that the CQCN be declared).

[1] See Aurizon, 'Review of Declared Services in the Central Queensland Coal Network – Submission to the Queensland Competition Authority' (30 May 2018) (**First Aurizon Submission**).

2 Background

The Central Queensland Coal Network (**CQCN**) is a very important facility and the re-declaration process has significant implications for the Queensland economy. As a result, the QRC welcomes the opportunity to make this submission and would welcome the opportunity to discuss this submission with the QCA secretariat.

The QRC is the peak representative organisation of the Queensland minerals and energy sector. The QRC's membership encompasses minerals and energy exploration, production and processing companies and associated service companies. The QRC works on behalf of members to ensure that Queensland's resources are developed profitably and competitively, and in a socially and environmentally sustainable way.

All operating Queensland coal producers are members of the QRC. A number of coal mining companies in the development and operating phase are also members of the QRC.

This submission has been prepared in close consultation with the QRC members. Generally speaking, for reasons of confidentiality, the members who have provided data or information to support this submission are not identified. The QRC can facilitate meetings with the individual members who have provided information, as well as provide some mine-specific data to the QCA. While the impacts of declaration differ between coal mining companies in terms of extent and severity, all coal mining companies would be seriously affected if the Service was not re-declared. In that sense, there are common themes across members and those themes are the focus of this submission.

3 Views on Aurizon submission

3.1 Aurizon has not engaged with the declaration process in good faith

The First Issues Paper invited stakeholders to *'consider and comment on specific matters as part of making submissions'*, while leaving it open for stakeholders to address any *'additional matters'* they wished to comment on.[2]

However, rather than commenting on the specific matters identified by the QCA and engaging with the wealth of relevant accepted jurisprudence and economic literature, Aurizon has merely treated its submission as an opportunity to criticise the QCA and the existing regulatory regime while putting forward a range of irrelevant or incorrect legal and economic considerations which are not helpful to the QCA's analysis. This is a further example of Aurizon's bad behaviour increasing regulatory cost (for example, in this case, by muddying the waters and seeking to confuse the key issues).

3.2 Aurizon's criticisms of existing regulatory regime are unfair

Aurizon's criticism of the current regulatory regime (and in particular the conduct of the QCA) is overstated, unfair to the QCA and not supported by appropriate evidence.

For example, the Aurizon submission focuses on the increasing cost of the undertaking process.[3] This assessment does not have any regard to what is in fact reasonable in the circumstances (e.g. an increase from a relatively low base may not necessarily be an unreasonable cost). Not does it take into account Aurizon's primary role in this increase

[2] First Issues Paper, iii.

[3] First Aurizon Submission, 22.

(i.e. it is Aurizon who proposes access undertakings in the first instance and therefore Aurizon could streamline the regulatory process by proposing a more reasonable undertaking at the outset rather than using the process to make ambit claims).

3.2.1 Existing regulatory regime has clear benefits

Aurizon's approach fails to acknowledge the significantly increased cost and time associated with negotiating access agreements outside of the regulatory regime. This was evident in the protracted contractual negotiations for both the Goonyella to Abbot Point Expansion (**GAPE**) and Wiggins Island Rail Project (**WIRP**). The QRC acknowledges that these negotiations were occurring in parallel with the development of the relevant export terminals. However, GAPE, for example, was first announced by Aurizon (then Queensland Rail) in October 2009 and it took an extended period of negotiations for the parties to finalise the relevant GAPE agreements. Similarly, there was considerable difficulty in reaching agreement between Aurizon and individual users on the WIRP Deeds which were negotiated and finalised outside of the regulatory access regime. The WIRP Deeds have also subsequently been the subject of constant dispute and significant associated cost.

For similar reasons, industry has also advocated for the development of a host of standard form agreements (at industry's cost) as part of the undertaking process. This has included, in addition to access agreements, standard form connection agreements, 'split form' access agreements and confidentiality deeds. This recognises the long term efficiency benefit of having a base document with agreed standard terms instead of engaging in prolonged negotiations for each individual agreement. These considerations are particularly relevant to smaller user entities (such as project specific entities) entering the market, which require standard access agreements to assist in remedying the power imbalance between them and monopoly infrastructure providers like Aurizon.

3.2.2 Examples of Aurizon bad behaviour

Aurizon's criticism of the increased costs of regulation also fails to acknowledge Aurizon's responsibility for these costs, for example:

- Aurizon only submitted the first draft of UT4 60 days before the expiry of UT3 without undertaking any industry consultation and including very broad ambit claims – this meant that UT4 was ultimately approved three years late;
- as a result of the delays to UT4, the UT5 regulatory process is considerably behind schedule – furthermore, Aurizon Network has failed to substantiate its UT5 claims, having provided numerous late submissions with the additional information required by the QCA;
- Aurizon has further delayed the UT5 process through its response to the QCA draft decision, particularly through its conduct in relation to maintenance changes and its judicial review application of the draft decision; and
- Aurizon has spent almost eight years (ongoing) negotiating the terms of a Standard User Funding Agreement (**SUFA**) required under the undertaking – when the QCA last required Aurizon to submit an amended SUFA, Aurizon withdrew SUFA and published its own incompatible alternative agreement.

Ultimately, the costs of regulation (whether the QCA's, Aurizon's or industry's) are borne by industry. Industry is willing to incur these costs because of the collective public interest in regulated access. These costs are also marginal when compared with the significant costs that would be borne by the industry outside of a regulated access regime.

Accordingly, the QRC submits that the QCA should ensure it considers both the costs and benefits of the existing regulatory regime, while taking care to ensure that the drivers of increasing regulatory costs are appropriately examined.

3.3 Aurizon has misapplied the relevant legal test

Aurizon argued that:

> *'The QCA and the Minister must be satisfied with a high degree of confidence that declaration is needed to ensure access to the CQCN in a manner that will achieve economic efficiency, so as to promote the public interest.'*[4]

However, Aurizon has misapplied the legal test that the QCA is required to consider. As the Second Counsel Opinion makes clear:

> *'The phrase "the public interest" permits a broad factual inquiry, based on a very wide range of matters. The word "satisfied" requires that the QCA feel an actual persuasion that the access (or increased access) referred to in Criterion (d) would promote the public interest. The QCA Act does not otherwise require that the QCA attain any "high" or other particular degree of confidence regarding its conclusion under Criterion (d); no "standard" of proof applies to the QCA, and no participant in the QCA's process bears any "burden" of proof.'*[5]

3.4 Aurizon has misapplied the relevant economic theory

Aurizon argued that:

> *'This is particularly so given that Aurizon Network is already materially, economically incentivised to maximise access to the CQCN and would be acting against its own interests to deny or offer access on uncommercial terms.'*[6]

However, as a vertically integrated rail operator, Aurizon has a strong incentive to discriminate against other above-rail operators (and, absent declaration, will have a clear ability to do so). As the Second RBB Expert Report notes:

> *'The potential for competition to be distorted in the rail haulage market in this case is clear. By refusing to provide access to third-party rail haulers, or by charging exploitative prices for access to its network to those third-party suppliers, Aurizon Network can prevent competition for rail haulage services from taking place, and instead reserve the rail haulage service for its own (integrated) operations. The effect of that is to lessen the rivalry at the rail haulage part of the supply chain. This will increase the margin earned by rail haulage suppliers and increase the price paid by miners for rail haulage.'*[7]

The QRC submits that the impact of this discrimination will be severe and will materially damage production, investment and employment.

3.5 Aurizon approach reflects their weak position

There is a long history of National Competition Council (**NCC**), Minister, Australian Competition Tribunal (**ACT**) and court decisions applying economic criteria to services provided by similar infrastructure. Aurizon has made very little attempt to engage with this material. These decisions deal with the application of the coverage criteria under the *National Gas Law* (**NGL**) and the declaration criteria under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**) (the latter of which the access criteria in the

[4] First Aurizon Submission, [5].

[5] Second Counsel Opinion, [7].

[6] First Aurizon Submission, [5].

[7] Second RBB Expert Report, [10].

Queensland Competition Authority Act 1997 (Qld) (**QCA Act**)) were recently amended to reflect).[8] Although the interpretation of these criteria has changed over the years (due to legislative amendment and ongoing judicial consideration), these decisions (and in particular the evidence accepted by the relevant decision makers) are still informative to the QCA review process.

The failure of Aurizon to truly engage with these decisions prevents the key issues in dispute from being drawn out. Instead, it requires other interested stakeholders to spend time and money engaging with irrelevant submissions.

The Aurizon approach reflects the fact that the weight of the relevant material supports declaration of the CQCN (i.e. Aurizon has presumably not engaged with the relevant decisions and evidence because they do not support Aurizon's position).

3.6 The QCA should adopt a clear decision making framework

The QCA has a statutory obligation to consider each of the submissions made in response to its investigation.[9] After considering the relevance and probative value of each submission, the QCA should apply a clear decision making framework that deals with the key issues that are ultimately material to the QCA's decision and set out its analysis and the supporting evidence relied upon regarding those issues (as per the approach regularly adopted by other regulators, Ministers, Tribunals and courts).

As demonstrated in the First QRC Submission,[10] upon a proper analysis it is clear that the access criteria are satisfied and the Service should be re-declared for a further 15 years (or longer). In brief:

- there is a single Service (being the use of the CQCN for providing transportation by rail) but if the QCA were to consider multiple Services, those Services must relate to the underlying infrastructure (rather than the Services proposed by Aurizon, which focus on irrelevant considerations such as the type of product being hauled using the Service);
- the Service satisfies the access criteria (as detailed in the First QRC Submission); and
- given the long investment horizons of the dependent markets, a 15 year (or longer) declaration period is appropriate.

4 Declared Service

4.1 Single declared Service

In defining the relevant Service, the starting point under the QCA Act is whether the currently declared Service should continue to be declared. This is clear when section 87A is read with section 87C. Section 87A provides that:

> '*…before the expiry date of a declaration of a **service**, the authority must recommend to the Minister that, with the effect from the expiry date –*
>
> *(a) the **service** be declared; or*

[8] Queensland, Parliamentary Debates, Legislative Assembly, 21 March 2018, 622 (Hon. JA Trad).

[9] QCA Act, s 174.

[10] QRC, 'QRC Submission – CQCN' (30 May 2018) (**First QRC Submission**).

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

*(c) the **service** not be declared.*'[11]

Under a proper construction of the QCA Act, it is clear that there is a single declared Service in relation to the CQCN (and therefore it is this Service that the QCA is required to assess as part of its declaration assessment).

'Service' is relevantly defined under the QCA Act as:

> *'… a service provided… by means of a facility and includes, for example.. the use of a facility (including, for example, a road or railway line)…'* [12]

The Service that is currently declared is *use of a* coal system for providing transportation by rail.[13]

Accordingly, as the *use of a* facility and the *use of a* coal system for providing transportation by rail are services, a coal system for providing transportation by rail is the relevant facility (**Facility**).

A 'coal system' means certain types of rail transport infrastructure (discussed below). The QCA Act defines 'rail transport infrastructure' by reference to the definition of that term in Schedule 6 of the *Transport Infrastructure Act 1994* (Qld) (**TIA**) and means facilities necessary for operating a railway.[14]

This definition includes a number of examples of the types of assets that comprise rail transport infrastructure, such as:

- railway track and works built for the railway, including but not limited to cuttings, drainage works and excavations; and
- things associated with the railway's operation, including but not limited to, bridges, communication systems, machinery and other equipment, marshalling yards, notice boards, over-track structures, platforms, power and communication cables and stations.[15]

The declared Service (as defined in the QCA Act) is made up of a coal system, which is comprised of rail transport infrastructure that is:

- part of any of the following:
  - the Blackwater system, being the railway connecting Gregory, Rolleston and Minerva to Gladstone, including the part of the North Coast Line between Parana and Rocklands;
  - the Goonyella system, being the railway connecting Gregory, North Goonyella and Blair Athol mine to the Port of Hay Point;
  - the Moura system, being the railway connecting Moura mine to Gladstone; and

[11] QCA Act, s 87A(1).

[12] QCA Act, s 72(1).

[13] QCA Act, s 250(1)(a).

[14] TIA Dictionary (definition of 'railway'). A 'railway' under the TIA means a guided system, or proposed guided system, designed for the movement of rolling stock that is capable of transporting passengers or freight, or both, on a railway track. This definition expressly includes rail transport infrastructure and expressly excludes rolling stock. For the purposes of the TIA, rolling stock is therefore viewed as functionally separate to 'below rail' infrastructure.

[15] TIA Dictionary (definition of 'railway' para (b)).

– the Newlands system, being the railway connecting Newlands to the Port of Abbot Point, including the part of the North Coast Line between Durroburra and Kaili; or

- directly or indirectly connected to a system mentioned above and owned or leased by the owner or lessee, or a related body corporate of the owner or lessee, of the system.[16]

The underlying Facility (and therefore the Service declared by the QCA Act) also includes extensions to a coal system referred to above after 30 July 2010, owned or leased by Aurizon that do not directly connect the coal system to a coal basin to which the coal system was not directly connected on 30 July 2010.[17]

Because the Service that is currently declared by the QCA Act includes the use of all coal systems that form part of the CQCN and extensions of them, it follows that the starting point for the QCA's analysis should be the Service that involves the use of all of these coal systems. That is, the QCA should commence by considering the Service provided by Aurizon's 2,718 km multi-user track network, known as the CQCN.

Further, the QRC submits that the QCA is not required to find that each *part* of the Service satisfies the access criteria in declaring the Service as a whole. As the Second Counsel Opinion provides:

> *'Section 87A(1) requires the QCA to recommend declaration of the presently declared service if it is satisfied about the Access Criteria in relation to that service. Under subsection (1), the service is treated as a whole and the Access Criteria are applied to it as a whole. There is nothing in subsection (1) that requires breaking the service up into parts and separate analysis of the Access Criteria in relation to each part.*
>
> *…there is nothing in [section] 87C(3) that suggests that the QCA must be satisfied about the Access Criteria for "all parts" of a service before recommending declaration of "any particular part" of a service.'*[18]

4.2 Aurizon approach is inconsistent with the QCA Act

4.2.1 Aurizon's proposed services

Aurizon has proposed 8 separate services:

- the use of a coal system for providing transportation by rail for services that originate from a coal basin which the coal system was not directly connected on 8 September 2020;
- the use of a coal system for the transportation of intermodal freight by rail;
- the use of a coal system for the transportation of passengers by rail;
- the use of a coal system for transportation of agricultural products by rail;
- the use of the Moura coal system for providing transportation by rail;
- the use of the Newlands coal system [inclusive of the Northern Missing Link] for providing transportation by rail;
- the use of the Blackwater or Goonyella coal system for providing transportation by rail; and

[16] QCA Act, s 250(1)(a), (3)(b).

[17] QCA Act, s 250(4).

[18] Second Counsel Opinion [13]-[14].

- the use of more than one existing coal system (cross system services) for providing transportation by rail.[19]

4.2.2 Aurizon departs from relevant starting point

As discussed in section 4.1 above, in defining the relevant service, the starting point is whether the currently declared Service (i.e. the Service in 4.1 above) should continue to be declared. It is therefore this Service that should be initially considered by the QCA.[20]

However, Aurizon's proposed definition of the relevant Service significantly departs from this existing definition and the question that needs to be considered under the QCA Act. Aurizon has defined the relevant Service according to different purposes and end users. The NCC Declaration Guide, which Aurizon refers to in its submission, specifically states that:

> *'The purpose for which the service is provided should be distinguished from the process of characterising a service by referring to the identity of particular users or the particular activity an access seeker intends to undertake if it obtains access. A service does not change with the identity of the access seeker or any particular operational ends for which access is sought: a distinct service is* ***not*** *identified by reference to each user or intended use of the service.'*[21]

Aurizon's sole justification for significantly departing from the existing definition of the relevant service is that the '*market conditions, existence or feasibility of substitutes and industry dynamics are sufficiently different to warrant independent consideration against the access criteria*'.[22] The QRC is not aware of any factual basis for this assertion (for which no supporting evidence is provided).

4.2.3 Aurizon incorrectly considers market analysis

Moreover, Aurizon's basis for its definition of services implies that there is a market definition component when assessing the relevant services. The QRC disagrees that this is an appropriate basis for defining the relevant service as it conflates the definition of the relevant service with the service's dependent markets. The QRC considers that the impacts of declaration on a particular commodity, such as coal, should be considered as part of the access criteria rather than when defining the relevant service. This is made clear by the fact that application of the access criteria necessarily follows the definition of the service.[23]

In particular, criterion (a) assesses the effect of declaration on competition in dependent markets. The market for export coal and the relevant market for agricultural products, for example, are both downstream markets that may be served by the Service. The impact on competition as a result of declaration in these dependent markets is thus considered in criterion (a).[24]

4.2.4 Aurizon's proposed services are clearly not services

The inconsistency of Aurizon's proposed definition is demonstrated by the fact that Aurizon's first four proposed services are clearly the same service (i.e. the use of a coal system for providing transportation by rail), merely described by potential operational uses. Providing a service to customers in different industries does not change the nature

[19] First Aurizon Submission, 38.

[20] See *Rio Tinto Limited v The Australian Competition Tribunal* [2008] ATPR 42-214, [58]

[21] NCC, *Guide to Declaration of Services*, 23.

[22] First Aurizon Submission, 38.

[23] QCA Act, s 76(1)(a).

[24] Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth) 11.

of the service provided by the facility or the function that it serves. Distinguishing the service based on its use is arbitrary and inconsistent with the QCA Act's object of promoting '*the economically efficient operation of, use of and investment in, significant* ***infrastructure*** *by which services are provided*'.[25]

4.2.5 Aurizon's approach is too narrow

In fact, attempting to define the relevant service by reference to the existing users or purposes for which the service is used may inadvertently exclude future users or purposes. The relevant service should therefore not be defined in an arbitrarily narrow way to ensure all access seekers are able to undertake their intended business activity.

Similarly, defining a point-to-point service, or a series of point-to-point services, risks defeating the purpose of declaration. Aurizon suggests that use of each of the Blackwater, Goonyella, Moura, and Newlands coal systems, and the use of more than one coal system for providing transportation by rail, each comprise a discrete service. The QRC submits that imposing such a geographic limitation upon the Service is too narrow and that such an interpretation is simply not available on the statutory construction of the current declared Service.

Accordingly, the QRC considers that the current definition of the Service under section 250 of the QCA Act (i.e. the use of the CQCN) ensures a more complete picture of the potential effects on upstream and downstream markets and is the most appropriate Service for the QCA to adopt for its analysis.

5 Criterion (d) – Public Interest

5.1 Relevance of the effectiveness of the existing regulatory regime

As the Second Counsel Opinion makes clear, criterion (d) invites a comparison to the relevant market environment without access:

> *'Criterion (d) requires a forward looking assessment of whether access (or increased access) via declaration would promote the public interest. This requires consideration of any benefits or detriments arising from access (or increased access) through declaration which may bear on the public interest. Such consideration inherently invites a comparison to the relevant market environment without access. As such, if there was evidence that the current regulatory regime had not been effective, in the sense that it was not achieving the objects of Part 5, or was imposing costs that outweighed the benefits of access, such evidence would be relevant to the QCA's assessment of Criterion (d).'*[26]

If there is evidence that the current regulatory regime is not effective in the sense of achieving the objects of Part 5, such evidence would be relevant to the QCA's assessment of criterion (d). The Second Counsel Opinion, however, emphasises that '*there is a difference between mere assertion and evidence. The QCA would be entitled to dismiss mere assertion as irrelevant.*'[27]

The QRC supports the analysis in the Second Counsel Opinion and submits that while the existing regulatory regime may have some relevance to the QCA's assessment, the

[25] QCA Act, s 69E.

[26] Second Counsel Opinion, [41].

[27] Second Counsel Opinion, [41].

QCA should exercise caution when considering the existing regulatory regime and should take into account the considerations set out below.

5.1.1 Future rather than existing state of the regulatory regime

If the QCA considers that the effectiveness of the existing regulatory regime is relevant to its assessment, the QCA should consider the future state of that regime rather than the existing state:

- care must be taken to ensure that the existing regime reflects a realistic future and no potential or anticipated changes are likely to result in the declared future diverging from the existing regime – e.g. when network optimisation is expected to occur this should be factored into the counterfactual analysis; and
- although Aurizon is highly critical of the existing regulatory regime,[28] the QRC submits that the undertaking process is workable and delivers public benefit to Queensland – in particular, the undertaking process is well understood and continues to be enhanced and refined at each iteration (i.e. UT4 is more comprehensive / certain than UT3… in this manner, each subsequent version is likely to further improve regulatory outcomes);

5.1.2 Unreasonable deficiencies of the regime should be excluded

Any deficiencies in the existing regime that are unreasonable should be excluded from consideration:

- for example, where the behaviour of Aurizon leads to increased regulatory cost, these costs should not be considered as a future cost of declaration – examples of such behaviour are set out in paragraph 3.2.2 above;
- from a policy perspective, failing to exclude these costs would create a perverse incentive for service providers to act unreasonably or to drive up costs, so as to increase their chances of successfully arguing that criterion (d) is not satisfied in a future declaration assessment;

5.1.3 Both the costs and benefits of any counterfactual must be considered

The QCA must ensure it considers both sides of the equation, rather than just simply considering the benefits of a proposed counterfactual:

- e.g. Aurizon has argued that the flexibility of a negotiate/arbitrate model (i.e. the alternative model that would apply if the CQCN was subject to a declaration under the National Access Regime in future) makes it superior to the existing regulatory regime and will allow it to reduce network inefficiencies;[29]
- however, negotiate/arbitrate has its own inefficiencies (namely, significant transaction costs associated with miners having to individually negotiate full terms and conditions of access with Aurizon) which are likely to outweigh any marginal increase in network efficiency;
- for Aurizon to only consider the benefits of this regime and not the costs is inappropriate and is a misapplication of the test under criterion (d) which requires comparison of the factual and counterfactual scenarios; and
- likewise, Aurizon has argued that '*given the competitiveness of the rail haulage market it becomes increasingly necessary for the access provider to incur the increase costs necessary to manage the operational variability*' – however, the QRC submits that this exposes a clear benefit of declaration (i.e. the

[28] First Aurizon Submission, 4.

[29] First Aurizon Submission, 20-21.

effectiveness of above-rail competition in promoting demand for throughput) and that any consideration of the 'costs' of this competition should be considered in light of the clear benefits.

5.1.4 The QCA should not rely upon Aurizon assertions

As noted in the Second Counsel Opinion, '*the possible application of price monitoring, other regulatory intervention and s 46 of the CCA to Aurizon Network or the CQCN Service are not likely to bear materially on the QCA's analysis of Criterion (a) in relation to the CQCN Service*.'[30]

In fact, the QRC submits that assertions regarding remote or speculative counterfactuals that are not supported by evidence should be excluded:

- the 'economies of scope' identified by Aurizon are unlikely to outweigh the potential costs to users resulting from behaviour driven by the interests of a vertically integrated provider;
- the National Access Regime was introduced because of well-recognised limitations of section 46 in facilitating access to infrastructure, as discussed in the Hilmer Review – accordingly, section 46, even in its amended form, provides an unlikely and ineffective alternative to providing access to facilities;[31] and
- as the Second Counsel Opinion outlines in relation to price monitoring:

  'As shown in the airport context, prices surveillance does not facilitate access or promote competition in dependent markets. At most it affords a degree of price constraint over monopoly services, and in the context of airports, even that constraint has been shown by ACCC reports to be weak. In any event, the CQCN Service is not currently subject to any price monitoring and there is no evidence that it will become subject to any such monitoring in future.'[32]

5.2 Relevant test

5.2.1 Decision making threshold

Aurizon argues that the QCA must be satisfied with a '*high degree of confidence*' that declaration is necessary and that the QCA must consider whether 'the public interest… could be substantially enhanced'.[33]

This overestimates the legal burden that must be met by the decision maker.

The QCA is not bound by technicalities, legal forms or rules of evidence when determining whether the services provided by the CQCN should be re-declared[34] and more generally the principle is that '*a decision maker must be satisfied that declaration is **likely** to generate overall gains to the community*'.[35] However, as the Second Counsel Opinion notes this is not a reference to a standard/burden of proof:

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[30] Second Counsel Opinion, [6].

[31] Second Counsel Opinion, [25]; see also Independent Committee of Inquiry, National Competition Policy (1993) (**Hilmer Report**), 243-244.

[32] Second Counsel Opinion, [25].

[33] First Aurizon Submission, 5 and 9.

[34] QCA Act, s 173(1)(b).

[35] Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth), 16 (emphasis added); First Aurizon Submission, 15.

'The phrase "the public interest" permits a broad factual inquiry, based on a very wide range of matters. The word "satisfied" requires that the QCA feel an actual persuasion that the access (or increased access) referred to in Criterion (d) would promote the public interest. The QCA Act does not otherwise require that the QCA attain any "high" or other particular degree of confidence regarding its conclusion under Criterion (d); no "standard" of proof applies to the QCA, and no participant in the QCA's process bears any "burden" of proof.'[36]

5.2.2 Relevant matters

Aurizon submits that criterion (d) requires a comparison between the costs of declaration and the expected benefits from allocative efficiency, arguing that:

> *'The public interest could be satisfied where the costs of regulation are substantially reduced through less prescription, increased incentives to invest and less commercial and regulatory rigidity to support increased coordination and supply chain efficiency.'*[37]

The argument that the declaration recommendation needs to be based purely on allocative efficiency is not only an over-simplification of what constitutes a benefit, but also a misapplication of the law. This argument fails to consider the breadth of matters that are relevant to criterion (d).

The matters that the decision maker must have regard to are outlined in section 76(5) of the QCA Act. However, this does not limit the wide scope of criterion (d). The *Queensland Competition Authority Amending Act* 2018 (**QCA Amending Act**) amended the criteria in the QCA Act to reflect the changes made to the equivalent access criteria under the National Access Regime in 2017.[38] Further guidance as to the scope of the matters that may be considered by the decision maker is provided in the Explanatory Memorandum to the *Competition and Consumer Amendment (Competition Policy Review) Act 2017* (Cth) (**2017 CCA Amendments**) which states that '*the Council and the Minister may have regard to a* ***very wide*** *range of matters*' (emphasis added).[39]A non-exhaustive list of matters includes:

- the effect that declaring the service would have on investment in facilities and markets that depend on access to the service;
- the potential for incentives to undertake investment in other significant infrastructure to decline because of a (real or perceived) risk that such infrastructure will be declared;
- the administrative and compliance costs that would be incurred by the provider of the service; and
- environmental and social costs and benefits, such as the costs to the local community of disruption or displacement associated with land acquisitions, or increased employment in the region as a result of investment in the new mine or a new rail line.[40]

As the NCC Declaration Guide states, '*it is impractical to exhaustively list all matters that are potentially relevant, particularly given each application presents unique factual*

[36] Second Counsel Opinion, 7.

[37] First Aurizon Submission,15.

[38] Queensland, Parliamentary Debates, Legislative Assembly, 21 March 2018, 622 (Hon. JA Trad).

[39] Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth), 17.

[40] Explanatory Memorandum, Competition and Consumer Amendment (Competition Policy Review) Bill 2017 (Cth), 17-19; *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36, [42].

circumstances'[41] and the broad scope afforded to decision makers in the legislation reflects the position of the High Court. In *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal,* the High Court held that the Minister may consider a '*great breadth of matters'* that can be encompassed by an inquiry into what is or is not in the public interest.[42]

Significantly, none of these costs or benefits (including the benefits of allocative efficiency) are more important to the QCA's decision than another – i.e. it is for the QCA to consider the costs and benefits and reach a decision regarding whether declaration promotes the public interest for the purposes of making a recommendation to the Minister.[43]

In this regard, the QRC supports the position put forward by Pacific National that:

> '*the public interest would at least extend to ensuring the promotion and facilitation of effective competition where this is feasible, and efficient investment in, and efficient operation and use of, critical transport infrastructure. This may be expected to deliver a range of economic benefits, including growth in economic output, employment and tax revenues.*'[44]

5.3 Incentives of a vertically integrated operator

It is widely accepted that a vertically integrated operator has the incentive to discriminate against downstream competitors. As noted in the Second RBB Expert Report, '*the Hilmer Committee argued that, even if access is not actually misused, the potential for such behaviour may deter new entry to, or limit vigorous competition in, markets dependent on access to the natural monopoly element*'.[45]

The QRC submits that it is clear that Aurizon has an incentive to discriminate against unrelated above-rail haulage providers such as Pacific National and BMA Rail.[46] Furthermore, in doing so, it has an incentive to maximise its own share in the above-rail market rather than maximising throughput of the CQCN (i.e. contrary to Aurizon's submission, Aurizon will not have the incentive to engage in output enhancing behaviour).

5.4 Impact of monopoly pricing

As set out above, Aurizon is a vertically integrated monopoly service provider with an incentive to extract monopoly rents from its customers. As the Second RBB Expert Report notes that:

> *'Access regulation is also needed to deal with the monopoly problem, which relates to the incentive that a natural monopolist below-rail operator has to raise the price of rail haulage charged to miners to the monopoly level. Monopoly prices could distort competition and efficiency in other markets even if they do not lead to a reduction of allocative efficiency in the below-rail market.'*[47]

Furthermore, the Second RBB Expert Report (quoting the ACCC Chairman) notes:

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[41] NCC Declaration Guide, 42.

[42] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36, [42].

[43] The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal [2012] HCA 36, [42].

[44] Pacific National, 'QCA declarations review: applying the access criteria – Pacific National's submission in response to the staff issues paper' (30 May 2018) (**First PN Submission**), 11 .

[45] Second RBB report, [29]; see also Hilmer Report, 241.

[46] First QRC Submission, 22.

[47] Second RBB report, [49].

'The view that monopoly pricing may cause competitive harm even if it does not lead to a reduction in the volumes carried by the below-rail infrastructure operator was clearly expressed by the Chairman of the ACCC in 2017:

Some commentators on the economic regulation of monopoly or near monopoly infrastructure have argued that any monopolistic pricing amounts to a pure transfer of economic rents between parties within the supply chain. That is, the transfer of economic rents between parties within a commodity export supply chain could occur without any impact on the production or investment decisions of users.

Such an argument defies all economic teaching that monopolists charge more and give less.

It also fails to consider the potential harmful impacts on investment and innovation in upstream or downstream industries.

One needs to understand that, in order to produce or extract a commodity like coal, this requires a major sunk investment in mining equipment and infrastructure. These sunk investments give rise to what are known as "quasi-rents" which are subject to the threat of hold-up.

The threat of expropriation of rents by a monopoly service provider in such a situation would only in extreme circumstances result in a pure transfer. More likely, even the threat of such expropriation can limit future investment and innovation by the upstream firms.

What miner would invest in reducing its extraction costs if it knew that the lower extraction costs would simply be met by higher port charges? More generally, what miner would invest in its mines knowing that the benefits of that investment could be expropriated by a monopoly somewhere else in the supply chain?

My point here is a simple one. To say we shouldn't be concerned about monopoly pricing because it is merely a transfer of economic rents is wrong in economic and commercial logic.'[48]

Accordingly, the QRC submits that the behaviour of a vertically integrated monopoly infrastructure provider is likely to harm the public interest. Aurizon's argument that price discrimination will bring new mines online is also unlikely to be correct in practice.

5.5 Weighing up costs and benefits of declaration

As set out in paragraph 5.2.2, Aurizon has failed to consider all benefits reasonably attributable to declaration. Instead, Aurizon has chosen to only examine whether the costs of declaration materially exceed the expected benefits of increased allocative efficiency. The QRC submits that this is a flawed approach.

Aurizon's claim that the increased costs and standardised pricing will reduce its incentive to invest in rail infrastructure fails to recognise that they will earn a regulated rate of return. This regulated rate of return reflects the risk of the investment and allows for a reasonable commercial return.[49] While asset stranding is a potential risk for Aurizon, it is not a new risk (i.e. it is a risk that infrastructure providers face / that existed when Aurizon was floated) and is a risk that a sophisticated infrastructure owner such as Aurizon can readily manage.

[48] Second RBB report, [41].

[49] QCA Act, s 168A(a).

The QRC also considers that the arguments made by Peabody Energy regarding the 'clear and compelling benefits' of declaration and the chilling effect on investment that a removal of declaration would have apply equally to the CQCN:

> *"The Queensland coal industry, including Peabody, has made historical investment decisions on the expectation that DBCT would remain a regulated asset. Removal of declaration would result in a windfall gain to the owners of the asset, and have a chilling effect on future investment in the Queensland coal industry."*[50]

The QRC submits that after weighing up the limited costs and the clear benefits of declaration, the only possible conclusion available to the QCA is that criterion (d) is satisfied.

6 Criterion (b) – Natural Monopoly

6.1 Aurizon approach to hypothetical greenfields test is flawed

Criterion (b) has been applied in various forms, including under tests of 'natural monopoly', 'net social benefit' and 'private profitability'.[51] The test of a natural monopoly involves a greenfields thought experiment of whether foreseeable demand would be more-efficiently serviced by one facility or by more than one facility.

Aurizon argues that the hypothetical greenfields test should not be applied because:

- the test does not deal with the circumstance where there is an already existing facility and is therefore contrary to public policy; and
- the test is at odds with the test in sections 76(2)(b), 76(3) and 76(4) of the QCA Act that provide for a comparison between the costs of using or extending the existing facility with the costs of using additional facilities to meet total foreseeable demand.

The QRC disagrees with this assertion and submits that application of the hypothetical greenfields test is appropriate under section 76(2)(b) of the QCA Act. As noted by Aurizon in its submission, application of the hypothetical greenfields test was endorsed by the Commonwealth Parliament in the 2017 CCA Amendments.[52]

The QRC submits that the hypothetical greenfields test is not inconsistent with sections 76(3) or (4). Section 76(3) provides that:

> '*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.'*

Consideration of 'reasonably possible' expansion is only relevant to identifying the costs of a hypothetical Facility for a costs comparison against using the Facility with one or more additional facilities. It does not turn criterion (b) into an 'economic to duplicate' test as Aurizon suggests.[53]

[50] First Peabody Energy Submission, [3.5]

[51] See Productivity Commission Report 2013, *National Access Regime*, Inquiry Report no 66 (**Productivity Commission)** 151-152.

[52] First Aurizon Submission, 35.

[53] First Aurizon Submission, 36, 42.

Similarly, section 76(4) has the effect of providing for a broad consideration of costs '*without limiting subsection (2)(b)*', which includes co-ordination costs.[54] It speaks to the kinds of costs that must be taken into account when considering costs in the relevant market under the greenfields thought experiment.

Accordingly, the QRC submits that the greenfields thought experiment of whether foreseeable demand would be more-efficiently serviced by one facility or by more than one facility is the correct approach.

As outlined in the First Counsel Opinion, criterion (b) is answered by reference to cost considerations in the relevant market.[55] Whether a second facility has been constructed, is in contemplation or is likely to emerge in the market is irrelevant.[56] The existence of a potential alternative service is only relevant to the extent it aids the cost consideration of a second facility in the greenfields thought experiment.[57]

In applying the natural monopoly test, the QRC considers that the only relevant consideration of possible substitute services are road haulage and rail infrastructure that could hypothetically be developed, as discussed in section 6.3.3.[58]

6.2 Declaration period of 15 years (or longer) is appropriate

The First Issues Paper requested submissions on the appropriate length of the declaration period.[59] As set out in the First QRC Submission, the QRC considers that a declaration period of 15 years (or longer) is appropriate for the Service.[60] The QRC considers that a declaration period of this length is consistent with the declaration periods for services provided by other railways and similar infrastructure, and provides sufficient certainty for access seekers and above rail operators to make investment decisions (amongst other reasons) as set out in section 4.3 of the First QRC Submission.

The QRC notes that Aurizon has suggested that a much shorter period of five years should be adopted.[61] Aurizon argues that there is no principled basis for a declaration period of longer than ten years because any regulatory regime founded upon '*assumptions as to utility and efficacy*' requires periodic review of the framework's performance.[62] The QRC disagrees with this argument.

The QRC considers that the Service should be re-declared for a minimum of 15 years. However, given the importance of the Service and the cost of the re-declaration process, the QRC submits that a longer declaration period would also be appropriate. The QRC notes that similar services have typically been declared for periods of 10-20 years.[63]

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[54] See First Counsel Opinion [63]-[65].

[55] First Counsel Opinion, [70].

[56] First Counsel Opinion, [70].

[57] First Counsel Opinion, [72].

[58] First Counsel Opinion, [71].

[59] First Issues Paper, 14.

[60] First QRC Submission, 3, 10, 34.

[61] First Aurizon Submission, 6.

[62] First Aurizon Submission, 49.

[63] See for example, National Competition Council, 'Application for declaration of a service provided by the Tasmanian Railway Network – Final recommendation' (14 August 2007) (Tasmanian Railways Declaration), [10.7]; National Competition Council, 'Application for declaration of a service provided by the Goldsworthy Railway network under section 44F(1) of the Trade Practices Act – Final recommendation' (28 August 2008), [1.16].

In determining the appropriate declaration period of 15 years rather than a shorter period, the QRC has assessed and balanced the following considerations:

- a longer declaration period would provide certainty for businesses and investment decisions in the long run, benefitting service providers, access seekers and other relevant affected parties;[64]
- a longer declaration period would permit realisation of the expected benefits from access and enable declaration rights to influence competition patterns in the relevant markets;[65]
- a longer declaration period increases the time that the public will receive the benefits resulting from the declaration;
- it is unlikely that significant technological developments will occur in the Below-Rail Market over a longer declaration period (i.e. any expected developments, such as increased electrification, are likely to occur in the first 10 years);[66] and
- it is unlikely that significant legislative change will occur in the future, given the considerable attention given to the access criteria through the recent processes in the Productivity Commission and the Government response to the Productivity Commission and Competition Policy Review Recommendations on the National Access Regime (**Harper Review**) (and noting that in any event the access criteria do not change regularly, having not changed previously in the CCA since 2010).

Furthermore, to the extent that significant changes occur in the future (e.g. technological development alters the Below-Rail Market), the risk that the access criteria might no longer be satisfied under a longer declaration period is mitigated by the fact that the owner of the facility (Aurizon) could apply for revocation.[67]

6.2.1 There are similar declaration periods under the National Access Regime

As discussed above and in section 4.3 of the First QRC Submission, there are a number of services provided by other railways and similar infrastructure that have been declared for ten years or more, such as the Tasmanian Railway and the Port of Newcastle.[68] These access regimes are similarly founded on assumptions as to utility and efficacy suggesting that a similar declaration period should be adopted for the Service.

6.2.2 Miners require long-term certainty

Furthermore, the QRC disagrees with Aurizon's submission that long-term certainty for access seekers is not a material consideration in determining the declaration period.[69] In the QRC's view, certainty of declaration is a key factor in miners' investment decision making, which is based on long term forecasts.

Neither members of the QRC nor Aurizon can control whether there are other changes that at a later point of time would justify the CQCN not being declared. However, the QRC

[64] PN Draft Recommendation, [11.3].

[65] PN Draft Recommendation, [11.3].

[66] PN Draft Recommendation, [11.4].

[67] QCA Act, s 88.

[68] National Competition Council, 'Application for declaration of a service provided by the Tasmanian Railway Network – Final recommendation' (14 August 2007) (Tasmanian Railways Declaration), [10.7]; National Competition Council, 'Application for declaration of a service provided by the Goldsworthy Railway network under section 44F(1) of the Trade Practices Act – Final recommendation' (28 August 2008), [1.16].

[69] First Aurizon Submission, 48.

submits that the fact that a declaration can be revoked supports a longer, rather than shorter, period. If a change in circumstances were to arise that resulted in the access criteria no longer being satisfied, Aurizon could apply for revocation.

Accordingly, the certainty provided to access seekers from a longer declaration period should be given greater weight than any risk of a change in circumstances that may justify a shorter period.

Relevantly, the QRC notes that the CCA does not have an equivalent provision – the NCC is entitled to recommend revocation, but there is no procedure for a service operator to require the NCC to consider the declaration status.[70] Accordingly, a longer declaration period under the QCA Act holds less risk for the owner of the facility, and is therefore even more appropriate, than under the National Access Regime.

6.2.3 Aurizon's proposed counterfactual is unlikely to arise

The QRC notes that there is no credible evidence to suggest that the potential changes referred to by Aurizon will in fact occur within the next five years (or any longer period). For example, Aurizon notes the prospect of significant technological change through the development of autonomous vehicles. However, it fails to mention the likely expense or community reaction from adopting autonomous road trains to provide a service that is currently provided by the CQCN. Furthermore, while such a change could lead to cost savings from reduced labour spend, this is unlikely to be material in the overall context of the supply chain and is not likely to lead to any increased efficiency (as network efficiency is arguably driven by availability of the underlying infrastructure rather than availability of drivers).

Equally, there is no certainty that any of the proposed mine and infrastructure development currently proposed will proceed in the next five years, if ever, and even then, the likely route of that infrastructure development. The QRC notes that other mine and infrastructure developments have been proposed in the past and reached an advanced stage of planning, but have not proceeded.[71]

6.2.4 QRC evidence of demand is clear

In addition, the long term forecasts provided by the QRC as part of the First QRC Submission suggest that there will be significant demand for the services provided by the CQCN over the next 15 years.[72] This is a projection supported by evidence, rather than a mere assertion (as per Aurizon's submission) which suggests that these are risks that should be dealt with if they arise rather than being assumed to arise to justify a shorter declaration period. This is particularly the case when the significant time, costs and resources involved in reviewing the regulatory regime are considered.

6.2.5 Aurizon's proposed shorter period would be costly and inefficient

These costs would be exacerbated by Aurizon's proposed five-year declaration period as this declaration would mirror the anticipated duration of the UT6 access undertaking. Inefficiencies will be created by reviewing whether the CQCN should continue to be a declared service so that a decision is made at the same time that the then current undertaking is expected to expire. Given declaration assessments take a considerable period of time (in part due to Aurizon's approach, as discussed in paragraph 3.2.2 above), the practical outcome of Aurizon's proposed five-year declaration period is that

[70] CCA, s 44J(1).

[71] See for example, Department of State Development, Manufacturing, Infrastructure and Planning, 'Sura Basin Rail' (6 December 2017) <https://www.statedevelopment.qld.gov.au/assessments-and-approvals/surat-basin-rail.html>.

[72] First QRC Submission, 12.

there will be a regular reassessment in the 3rd/4th year of each declaration period. This would be highly inefficient and impose a significant regulatory burden. That cannot be the intention of the regime.

Such a situation invites the question as to how such an approach would operate in practice:

- it may be intended that the review of whether declaration should continue runs in parallel with the approval of a new access undertaking, but this would result in the two processes operating simultaneously - this would unnecessarily stretch the resources of the QCA, the QRC, Aurizon and other interested participants; and
- alternatively, if the processes are not carried out simultaneously, it is not clear what would be intended to apply in the interim period following a declaration while a new access undertaking is approved. A situation where no access undertaking applied would give miners little benefit from the continuation of the declaration and create uncertainty. On the other hand, a situation in which the previous access undertaking was to continue to apply (with retrospective amendments being made once a new access undertaking is finalised) would lead outcomes similar to the status quo (which Aurizon criticised in its submission).

6.3 Cost comparison

The QRC agrees with DBCT Management and Aurizon that the relevant cost comparison is between the cost of using the existing facility (with the necessary expansions) to service total foreseeable demand against the cost of using the existing facility together with one or more alternative facilities.[73]

As outlined in the First DBCT Management Submission and the First Counsel Opinion,[74] the relevant costs are broad, incorporating the incremental costs to society. That is, criterion (b) requires consideration of how resources can be allocated optimally from a social economic welfare perspective to meet demand.[75] It is not confined to the private costs to miners of accessing different coal-transport services.[76]

6.3.1 Sunk costs

The QRC agrees with Aurizon and DBCT Management that the sunk costs of an existing facility, which will not be incurred again over the prospective declaration period, should be excluded from consideration.[77] In particular, the QRC agrees with DBCT Management's submission that:

> '*even if the sunk costs of existing rail and terminal infrastructure were to be taken into account in an assessment of least cost, these costs would be captured under all scenarios in which total foreseeable demand in the market is met and are therefore not relevant to determining whether the facility for the service can meet that demand at least cost.*'[78]

[73] First Aurizon Submission, 36; First DBCT Management Submission, 17.

[74] First DBCT Management Submission, 17.

[75] First DBCT Management Submission, 35.

[76] First DBCT Management Submission, 35.

[77] First DBCT Management Submission, 37.

[78] First DBCT Management Submission, 37.

6.3.2 Cost of using the existing facility (with expansions)

In assessing the nature of possible expansions under section 76(3) of the QCA Act, DBCT Management notes that:

> *'a capacity expansion for a particular facility may be reasonably possible if it is reasonably capable of occurring during the declaration period…in this regard that the relevant definition of 'possible' in the Macquarie Online Dictionary is "capable of existing, happening, being done, being used".'*[79]

This definition is substantially similar to that provided by the QRC.[80]

The QRC agrees with DBCT Management that factors relevant to determining whether capacity expansion is reasonably possible include:

- circumstances of the particular facility;
- work involved in the expansion;
- legal and regulatory constraints or impediments to expansion;
- costs of expansion; and
- the degree of control the service provider has over the ability to expand.[81]

6.3.3 Cost of using the existing facility with one or more alternative facilities

The QRC submits that road haulage is clearly not a viable option in terms of price. There are also no alternative below-rail facilities available in the market for the Service.

The only relevant alternative facilities are those that could be developed in the future. According to the Calibre Expert Report, developing a new facility as an alternative to the CQCN would cost approximately $20bn.[82] Furthermore, the QRC submits that it would not be possible to develop a 90MTpa facility (i.e. a facility that simply meets excess demand requirements) at least cost compared to an expansion of the CQCN. Given the high cost of developing rail infrastructure ($7m per kilometre of track),[83] the QRC submits that there are no alternative facilities that could meet excess demand at a lower cost than the Facility.

As a result, it is clear that expanding the CQCN to meet this demand through a single Facility will cost less than developing a new Facility to meet this demand through two or more facilities.

[79] First DBCT Management Submission, 19.

[80] First QRC Submission, 30.

[81] First DBCT Management Submission, 19.

[82] Calibre Expert Report, section 5.4.

[83] Calibre Expert Report, section 5.4.

7 Criterion (a) – Promotion of Competition

7.1 QCA's framework is correct

The QRC considers that the approach proposed in the First Issues Paper is the appropriate framework in which to assess the application of criterion (a) and therefore agrees with the formulation put forward by Aurizon.[84] That is, the process involves:[85]

- identification of the dependent (i.e. upstream or downstream) markets;
- consideration of whether those markets are separate from the market for the Service to which access is sought; and
- assessing whether access (or increased access) resulting from the declaration would promote a material increase in competition in any of the dependent markets.

This is also consistent with the approach taken by the NCC in its most recent guidance on Part IIIA of the CCA.[86]

Accordingly, the QRC disagrees with the submission of Queensland Rail that the test of whether declaration would 'promote a materially more competitive environment' is too low a threshold for the satisfaction of criterion (a).[87] The QRC considers that this test is consistent with the current drafting of criterion (a), which (like the test set out in the First Issues Paper), specifically refers to the promotion of competition being 'material' and the legislative intention behind those amendments.

7.2 Relevant Test

The majority of submissions, including those made by DBCT Management, have broadly agreed with the QCA's approach to considering this criterion, namely that:[88]

> *'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.'*

Aurizon appears to be an exception to this broad consensus. In its submission, it noted that '*competition in the relevant dependent market will be promoted*'[89] (without any further elaboration as to what this referred to).

DBCT Management similarly appears to potentially take issue with the QCA's reference to *Re Sydney Airports* to the extent that it does not consider the wider relevant material (which there is no suggestion from the QCA that this is the case). DBCT Management notes specifically that:

> '*The QCA would therefore err if it sought to solely apply the Re Sydney Airports interpretation of criterion (a) and considered only whether declaration would create an enhanced competitive environment, without having regard to the actual words of the legislation and the requirement that it must be positively*

[84] First Aurizon Submission, 34

[85] First Issues Paper, 19.

[86] NCC Declaration Guide, [3.3].

[88] First Issues Paper, 18.

[89] First Aurizon Submission, 35.

satisfied that declaration would promote a material increase in competition in a market.'[90]

Outside of these narrow objections there seems to be a wide acceptance that the QCA's chosen approach is the correct one. For example, the QRC agrees with the following statement from Peabody Energy:

'*Peabody agrees with the QCA Staff paper that it is not necessary to demonstrate that competition will be enhanced by declaration, but only that there is a competitive environment and that the conditions for competition are enhanced, consistent with the approach of the Competition Tribunal in Sydney International Airports.*'[91]

Peabody Energy quoted the following in support of its submission:

'*we need to be satisfied that if the Airside Service is declared there would be a significant, finite probability that an enhanced environment for competition and greater opportunities for competitive behaviour – in a non-trivial sense – would arise in the dependent market.*'[92]

The QRC considers that, consistent with the First Issues Paper, the relevant consideration in assessing 'material promotion' is not Aurizon's apparent view of whether there is an increase in competition, but rather whether there will be an enhancement of the competitive environment and greater competitive opportunities in the dependent market.[93] In short, the question is whether declaration would create the conditions or an environment where there is a non-trivial enhancement of the conditions or environment for improving competition.[94]

As part of the analysis required by *Duke Eastern Gas Pipeline Pty Ltd*,[95] consideration should be given to the relevant industry and market structures surrounding the dependent market, as well as the potential ability and/or incentive of the operator of the Service to adversely affect competition in that dependent market absent such a declaration.[96]

7.3 Reliance on Port of Newcastle

Aurizon submits that the *Port of Newcastle* decision[97] 'should be given reasonable weight given its explicit consideration of the whether declaration would promote a material increase in competition'.[98]

The QRC rejects Aurizon's reliance on this decision and agrees with Pacific National's submission that:

'*given the recent amendments to criterion (a), the proper approach to the counterfactual is different to that adopted by the Tribunal and Full Federal Court in Port of Newcastle. The test is no longer a simple 'access or no access' test.*

[90] First DBCT Management Submission, 60.

[91] Peabody Energy, 'Peabody Energy Australia Response to QCA Staff Paper' (30 May 2018), 7 (**First Peabody Submission**), 7; *Sydney International Airport* [2000] ACompT 1.

[92] First Peabody Submission, 8; *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [155]-[162].

[93] *Virgin Blue Airlines Pty Limited* [2005] ACompT 5, [155].

[94] *Sydney International Airport* [2000] ACompT 1, [106]-[107].

[95] *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2.

[96] *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2, [116].

[97] *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124.

[98] First Aurizon Submission, 35.

> *The question in this context is whether the removal of declaration (as opposed to the absence of access altogether) would adversely affect the competitive environment.*'[99]

As such, the correct approach to the QCA's consideration is that set out in this submission.

7.4 Competition in the Above-Rail Market

As explained in the First QRC Submission, Aurizon enjoys a leading position in the Above-Rail Market, accounting for more than two-thirds of coal hauled in Queensland.[100] This will only increase if the Service is not re-declared, for the reasons outlined below.

7.4.1 Effect of current declaration

Declaration has contributed to increased competition in the Above-Rail Market. Notably, Pacific National's entry was made possible primarily by the regulatory framework resulting from the declaration which provided the necessary environment for competition to grow. The increased regulatory certainty from declaration also made Pacific National's significant haulage contracts with Rio Tinto Coal Australia and Xstrata Coal[101] possible, at least in part, from the regulatory certainty from the declaration which contributed to its entrance into the market.

In its response to the First QCA Issues Paper, Pacific National itself made clear that the access rights made possible under the declaration of the CQCN are 'critical' for Pacific National to compete with Aurizon in the Above-Rail Market.[102] Pacific National also drew out the tension in its competition with Aurizon:

> '*PN is the second largest operator of coal freight services in the CQCN, after Aurizon (which also owns Aurizon Network and delivers access on the CQCN). PN also has to negotiate access to the CQCN (namely the sections between Parana and Rockland, and between Kaili and Durroburra) for its containerised freight services to operate between Brisbane and Cairns. Aurizon is therefore both a major competitor to PN and the monopoly supplier of the access rights that critically enable PN to compete with Aurizon in the Queensland freight market.*'[103]

The presence of Pacific National has meant that Aurizon's total share of the Above-Rail Market has noticeably reduced following the entry of Pacific National in FY09. Since FY13, Aurizon's share of the Above-Rail Market has declined from approximately 85% to approximately just above 70% in FY17.[104] Increased productivity gains and operating improvements such as the introduction of electronically controlled pneumatic braking, increased locomotive power and safe operation of over-length trains have been noted as impacts resulting from Pacific National's presence in the Above-Rail Market.[105]

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[99] First PN Submission, 9.

[100] Calculated using figures from pages 15 and 17 in Aurizon, 'Annual Report 16-17' (August 2017) <http://www.aurizon.com.au/~/media/aurizon/files/investors/documents%20and%20webcasts/2017/full%20year%20results/annual%20report%202017.pdf>.

[101] Rail Express, 'PN commences QLD coal haulage operations' (13 May 2009) <https://www.railexpress.com.au/pn-commences-qld-coal-haulage-operations/>.

[102] First PN Submission, 3.

[103] First PN Submission, 7.

[104] First QRC Submission, 18.

[105] Pacific National, 'QCA draft decision – Aurizon Network's 2017 draft access undertaking' (Submission on QCA Draft Decision, March 2018) 8.

In the First QRC Submission, the QRC outlined the inherent risks to entry / expansion in the Above-Rail Market, and how these can be overcome, or at least minimised, via declaration.[106]

7.4.2 Aurizon's comments on enhanced competition resulting from declaration

Despite the level of competition in the Above Rail Market being critical to the analysis of criterion (a), Aurizon curiously makes no reference to Pacific National in its submission. The QRC has had to look to other statements of Aurizon for acknowledgement that: '*a competitive haulage market is putting **some** pressure on contract prices*'.[107]

7.5 Aurizon would have the ability and incentive to exert market power

In the paragraph 5.3 above and in the First QRC Submission, the QRC explained that Aurizon has, absent declaration, both the ability and incentive to exploit its monopoly in the Below-Rail Market to adversely affect competition in the Above-Rail Market.[108]

Importantly, Aurizon makes reference to the following excerpt of the Productivity Commission:

> *'Intervention to require access where the infrastructure service provider has no ability to affect prices in downstream markets risks lowering efficiency and, in the long term, adversely affecting incentives to invest in markets for infrastructure services'.*[109]

However, the QRC submits that Aurizon (as a vertically integrated rail operator) clearly does have *the incentive or ability to deny access*. Further, Aurizon itself actually offers economic analysis and evidence which reinforces that it has the ability and incentive to deny access. Importantly, it states that:

> *'The industrial organisation literature for railways has generally concluded that the optimally efficient market structure for railways is vertical integration because of the transaction costs associated with separation and the coordination failure of the below and above rail operations from vertical unbundling. While access regulation can safeguard the inefficient duplication of significant infrastructure, it will prima facie involve lower productive efficiency due to the loss of economies of scope of integrated operations.*'[110]

As the Second RBB Expert Report makes clear, this is not correct:

> *'Whether or not those costs exceed the benefits from the society as a whole is ultimately an empirical question. But rather than present evidence on the costs (and benefits) of declaration, Aurizon Network relies on a brief literature review to claim that the industrial organization literature for railways has generally concluded that the optimally efficient market structure for railways is vertical integration. However, one of the studies that Aurizon Network actually relies on to make that claim flatly contradicts it and finds instead that there is no clear view about the optimal structure of railway networks. For example, that study finds that the optimal market structure will depend on train density and that*

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[106] See First QRC Submission, 20.

[107] Aurizon, '1HFY2018 Results' (12 February 2018) 7 (emphasis added) http://www.aurizon.com.au/~/media/aurizon/files/investors/documents%20and%20webcasts/2018/interim%20results/hyr%202018%20investor%20presentation.pdf.

[108] First QRC Submission, 20.

[109] First Aurizon Submission, 12.

[110] First Aurizon Submission, 14.

vertical separation tends to reduce the total costs of a railway network when train density is relatively low.'[111]

The QRC submits that Aurizon's past behavior supports its view that vertical integration will lead to negative outcomes and agrees with Peabody that:

'*Aurizon Network (Aurizon) has demonstrated that it is capable of exploiting its monopoly position in order to maximise its commercial interests, irrespective of the adverse consequences for customers and competitors. The recent approach of Aurizon seeking to impose inflexible maintenance practices in an effort to pressure industry and the QCA in an effort to achieve a better rate of return outcome in UT5 is a clear case in point."*[112]

"The experience of Peabody (through its interest in Middlemount) and other users of the GAPE system in relation to the unregulated funding arrangements for the Northern Missing Link. The resulting commercial arrangements (under a series of 'GAPE Deeds') continue to be a source of high cost and disputes between Aurizon and industry. Similarly contentious negotiations over the funding of the WICET expansion, which ultimately led to litigation between Aurizon and the QCA. The very recent spectacle of Aurizon seeking to use inflexible maintenance practices to place pressure on the QCA and industry in an attempt to achieve higher rates of return.'[113]

QRC also agrees with the position of Peabody Energy, that:

'*The potential for such vertical integration, which would not be subject to any form of regulation by the QCA, creates a material risk of chilling competition in a number of related markets, including markets for the provision of rail services and the existing market for secondary capacity trading.*'[114]

These examples demonstrate that, even when subject to declaration, Aurizon has shown that it has the incentive to make damaging unilateral decisions. The likelihood of further damaging conduct would only be increased were the Service not re-declared.

7.6 No credible threat of bypass

Railways such as the CQCN have regularly been considered natural monopolies. There are no credible alternatives to rail transport and no competing below-rail facilities. Similarly, given the prohibitive costs involved, access seekers are not practically able to sponsor new entry into the Below-Rail Market. As such, there is no credible threat of bypass and Aurizon would have the ability and incentive to take advantage of its position in dealing with potential competitors of its related above-rail business.

7.7 Commercial terms

While Aurizon may continue to offer some form of access to the CQCN to some access seekers absent declaration, that does not mean that it would offer commercial terms consistent with those existing under declaration. Aurizon's incentive, as a vertically integrated operator free from constraints, would be to favour its related above-rail business over competitors such as Pacific National, maximising its profits while simultaneously damaging competition in the Above-Rail Market.

[111] Second RBB Expert Report, [17].

[112] First Peabody Submission, 4.

[113] First Peabody Submission, 4.

[114] First Peabody Submission, 9.

Aurizon could use its power to discriminate in a number of ways as explained in the First QRC Submission,[115] including by pricing inefficiently to maximize its profits rather than maximizing the through-put on the CQCN and discriminating on price and other conditions where an access seeker does not use its vertically integrated above-rail provider.

In line with the above approach, the QRC is of the view that Pacific National's following submission to the QCA is the correct approach:

> '*In the context of a re-declaration inquiry, an important question under criterion (a) becomes whether the removal of declaration will adversely affect the competitive environment, compared to a world where declaration continued. This raises important considerations on the relevant 'counterfactual', including:*
>
> - *the extent to which key structural protections – such as vertical separation, ring fencing arrangements, transparent and non-discriminatory pricing principles – are likely to remain in place if declaration was removed;*
> - *the extent to which existing coal supply chain logistic improvements have been facilitated by regulation and whether such supply chain improvements will continue if declaration was removed;*
> - *the extent to which existing commercial pricing arrangements have been facilitated by regulation and whether they are would be likely to continue if declaration was to be removed';*
>
> *…*'[116]

These key structural protections, in addition to those outlined in the First QRC Submission, will be lost if the Service is not re-declared. Aurizon would then have both the ability and incentive to remove these protections with its monopoly power in the Below-Rail Market, adversely affecting competition in the Above-Rail Market.

8 Criterion (c) – State Significance

8.1 CQCN is clearly significant

Aurizon has overstated the requirements for a service to be significant under criterion (c). Criterion (c) is in its nature, a political question, with the High Court commenting that it '*may also [like criterion (f)] direct attention to matters of broad judgment of a generally political kind*'.[117] Furthermore, unlike the other criteria, criterion (c) does not necessitate a counterfactual enquiry (i.e. a Facility is either significant or it is not). Therefore, Aurizon's argument that criterion (c) 'necessitates consideration as to whether that lost output would be foregone or replaced such that the impact on the state economy is not significant (noting mobility of labour or substitution of outputs)'[118] is incorrect.

It is clear that the Service, being the use of the CQCN for providing transportation by rail, is significant under criterion (c): the CQCN is Australia's largest export coal rail network

[115] First QRC Submission, 22.

[116] First PN Submission, 9.

[117] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36, [43].

[118] First Aurizon Submission, 36.

and enables the coal industry to contribute $36,435 million to Queensland's economy.[119] Moreover, the CQCN's significance to the State of Queensland is arguably demonstrated by the fact that it was deemed to be declared under section 250 of the QCA Act[120] (i.e. it was considered significant enough by the Government/Parliament to declare it in the first place). There are only two other services that are treated in a similar way.[121]

The QRC submits that there has been no dramatic change in the significance of the CQCN to the Queensland economy since it was first deemed to be declared (and, if anything, the significance of the CQCN is likely to have increased). The fact that its declaration is currently being reviewed as required by subdivision 4A of the QCA Act does not detract from this. The second reading speech to the introduction of that subdivision further supports this analysis:

> '*While the government has only declared or excluded services where it has* ***clearly been appropriate*** *to do so, the removal of the regulation-making power will eliminate any potential uncertainty and ensure that coverage is guided in every instance by the legislated access criteria.*'[122]

8.2 Size or importance

Criterion (c) requires that the QCA have regard to the size and importance of the CQCN to the Queensland economy,[123] but Aurizon itself has acknowledged that only one aspect of either size or importance is required to be satisfied.[124] However, Aurizon states that:

> '*The basis for the assessment should contemplate the impacts associated with the counterfactual of there being no facility, such as in the event of natural disaster which meant the service was no longer able to be provided by the facility.*'[125]

As set out above, the QRC submits that criterion (c) does not involve a counterfactual enquiry. Further, if the size of the Facility can lead to the conclusion that the Facility is significant, then this implies that criterion (c) does not *require* consideration of whether the lost output from the Facility is significant to the state economy (i.e. the Facility need only satisfy at least one of either size and importance).

8.3 Application to Moura systems

Furthermore, in splitting the CQCN into various services, Aurizon argues that the Moura system alone is not significant to the Queensland economy.[126] For the reasons set out in section 4.1, the QCA should not adopt Aurizon's definition of the Moura system as a separate service.

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[119] QRC 'Economic contribution survey data 2016-17', https://www.qrc.org.au/contributiontoqueensland/contributiondata/ (Refer to Schedule 2 of the First QRC Submission; Aurizon Holdings Limited, *Network* (2018) <https://www.aurizon.com.au/what-we-deliver/network> (accessed 16 July 2018).

[120] Originally by regulation – See also First PN Submission, 12.

[121] QCA Act, s 250.

[122] Second Reading Speech, Motor Accident Insurance and Other Legislation Amendment Bill (5 August 2010), 2517.

[123] QCA Act, s 76(2)(c).

[124] First Aurizon Submission, 36.

[125] First Aurizon Submission, 36.

[126] First Aurizon Submission, 44.

However, even if the QCA decides to consider the Moura system as providing an individual service, then the QRC submits that the Moura system satisfies criterion (c). In particular:

- the Moura system (315 km)[127] is larger in size than the Goldsworthy Railway (210 km), which has been found to be nationally significant;[128]
- the Moura system would continue to be significant given its importance to the regions that it serves and the jobs that it provides;
- the royalties provided by the mines on the Moura system are significant for the Queensland economy – by way of comparison, the Department of Education and Training is currently spending $152 million over three years to deliver the Queensland Government's 'Extra Teachers' election commitment to hire up to 875 additional teachers; the royalties from the Moura system could pay for this key election commitment three times over.[129]

Moreover, Aurizon's comparison of the Moura system to other systems on the CQCN is unhelpful. Criterion (c) is concerned with the significance of the Facility in question. If the QCA determines that the Moura system provides an individual service, then it must consider its significance in isolation to the other systems (i.e. it is not relevant that one system is more or less significant than another, merely that it is significant).

Finally, even if the QCA accepts Aurizon's argument that criterion (c) requires a counterfactual enquiry (which as set out above the QRC submits the QCA should not), the QRC submits that the QCA should carefully consider the likely counterfactual scenario (and in particular, the likely impacts of removing declaration would have on production and labour). Although Aurizon has invited the QCA to consider these factors,[130] it does not present any useful or persuasive material. The Second RBB Expert Report illustrates the difficulty of reaching firm conclusions on these factors without detailed evidence regarding the global supply curve.[131]

9 Conclusion

As can be seen above, Aurizon's submission does not appropriately engage with the relevant materials and therefore is unlikely to assist the QCA.

The QRC submits that the QCA should apply the decision-making framework set out in the First and Second Counsel Opinions and, in doing so, recommend declaration of the Service.

[127] Aurizon, 'Moura System Information Pack- Issue 7.0' (March 2017), 9 <https://www.aurizon.com.au/~/media/aurizon/files/what%20we%20do/network/network%20downloads/cqcn%20info%20packs/auz014_infopack_moura_ia_r1.pdf>.

[128] *Re Fortescue Metals Group Limited* [2010] ACompT 2, [4] and [795].

[129] Queensland Government, 'Palaszczuk Government delivers extra teachers and teacher aides' (Media release, 23 June 2017) 1 <http://statements.qld.gov.au/Statement/2017/6/23/palaszczuk-government-delivers-extra-teachers-and-teacher-aides>; Queensland Government, 'Extra teachers, guidance officers, roll out in Queensland state schools as the school year starts' (Media release, 27 January 2016) <http://statements.qld.gov.au/Statement/2016/1/27/extra-teachers-guidance-officers-roll-out-in-queensland-state-schools-as-the-school-year-starts>.

[130] First Aurizon Submission, 44.

[131] Second RBB Expert Report,

Attachment 1 – Second Counsel Opinion

IN THE MATTER OF

THE QUEENSLAND RESOURCES COUNCIL

AND

THE DECLARATION REVIEWS BEING CONDUCTED BY THE QUEENSLAND COMPETITION AUTHORITY

FURTHER OPINION

A. Introduction

A.1 Background

1. We refer to our previous opinion dated 30 May 2018 (**May Opinion**).

2. Since we provided our May Opinion, the Queensland Competition Authority (**QCA**) has invited comments on submissions made in response to its paper titled "Declaration reviews: applying the access criteria". One such submission is from Aurizon Network Pty Ltd (**Aurizon Network**) titled "Aurizon Network – Review of Declared Services in the Central Queensland Coal Network, 30 May 2018" (**Aurizon Submission**). The QCA has also invited comments on questions identified in a document published by the QCA, titled "Declaration Reviews: Submissions on Initial Submissions – Staff Questions" (**QCA Questions**).

3. We have been asked to provide an opinion on the following questions arising out of the Aurizon Submission and the QCA Questions, so far as they concern the declaration of the service or services constituting the use of any part of the railway network known as the "Central Queensland Coal Network" (**CQCN**), which we refer to as the "**CQCN Service**".

   (a) (**First Question**) Whether, under the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**), the QCA must ensure that "all parts" of a service satisfy the access criteria in s 76 of the QCA Act (**Access Criteria**) before making a recommendation to declare "any particular part" of a service.

   (b) (**Second Question**) The relevance (if any) of an assessment of the effectiveness of alternative forms of regulation to the QCA's application of the access criterion in s 76(2)(a) of the QCA Act (**Criterion (a)**),[1] including:

[1] We use "Criterion (a)" to refer to both the criterion in s 76(2)(a) of the QCA Act and the criterion in s 44CA(1)(a) of the *Competition and Consumer Act 2010* (Cth) (**CCA**), which is in identical terms, save that it uses the word "one" rather than the numeral "1".

(i) price monitoring;

(ii) potential regulatory intervention; and

(iii) s 46 of the *Competition and Consumer Act 2010* (Cth) (**CCA**).

(c) (**Third Question**) The correct approach for the QCA to apply the access criterion in s 76(2)(d) of the QCA Act (**Criterion (d)**),[2] including:

(i) the relevant factors that the QCA must or may consider when applying this criterion, and how the application of this criterion should be approached;

(ii) the relevance (if any) of:

(A) an assessment of the effectiveness of the current regulatory regime (including the approval and administration of access undertakings);

(B) an assessment of the effectiveness of alternative forms of regulation, including:

(I) price monitoring;

(II) potential regulatory intervention; and

(III) section 46 of the CCA; and

(C) a cost benefit comparison of the current regulatory regime to alternative regimes;

(iii) the interpretation of the words "would promote the public interest"; and

(iv) the level of satisfaction required on the part of the QCA before it can be "satisfied" within the meaning of s 76(1)(a) of the QCA Act.

4. We respond to these questions in Parts B, C and D. In doing so, we draw on the facts described in Part B of the May Opinion, and the legislation described in Part C of the May Opinion. As observed in the May Opinion, the relevant extrinsic materials to the introduction of Criterion (b) in its current form reveal that the access criteria under Part 5 are intended to reflect the equivalent criteria under Part IIIA of the CCA.[3] Accordingly, it is appropriate to have regard to the background to the introduction of those criteria under the CCA as well as under the QCA Act when considering their interpretation. Decisions on the previous forms of Criterion (a) and Criterion (d) may also have some relevance to the

[2] We use "Criterion (d)" to refer to both the criterion in s 76(2)(d) of the QCA Act and the criterion in s 44CA(1)(d) of the CCA, which is in identical terms.

[3] Contained in CCA, s 44CA; see: *Queensland Competition Authority Amendment Bill 2018 – Explanatory Notes*, at 1-2 and 5.

interpretation of the current criteria, to the extent that the statutory language, read against the background to its introduction, evidences an intention to adopt a particular concept in the same way that it was previously applied.

A.2 Summary of answers

5. *First Question*: The QCA is not required to be satisfied about the Access Criteria for "all parts" of a service before recommending declaration of "a particular part" of a service. The QCA need only be satisfied about the Access Criteria in relation to the part of the service that is the subject of the recommendation.

6. *Second Question*: Alternative forms of regulation other than declaration under Part 5 of the QCA Act may be relevant to the analysis of Criterion (a), to the extent that such regulation could appreciably affect the analysis of competition in a relevant dependent market in the future with or without access (or increased access). The weight to be given to such considerations would be a matter for the QCA, but would be affected by the likelihood that the postulated regulation would be implemented absent declaration under Part 5 and the likely effect of the postulated regulation on competition in dependent markets if implemented in comparison to declaration under Part 5. However, for the reasons explained below, in our opinion the possible application of price monitoring, other regulatory intervention and s 46 of the CCA to Aurizon Network or the CQCN Service are not likely to bear materially on the QCA's analysis of Criterion (a) in relation to the CQCN Service.

7. *Third Question*: In order to be satisfied of Criterion (d), the QCA must be positively satisfied that the relevant access would promote the public interest. The phrase "the public interest" permits a broad factual inquiry, based on a very wide range of matters. The word "satisfied" requires that the QCA feel an actual persuasion that the access (or increased access) referred to in Criterion (d) would promote the public interest. The QCA Act does not otherwise require that the QCA attain any "high" or other particular degree of confidence regarding its conclusion under Criterion (d); no "standard" of proof applies to the QCA, and no participant in the QCA's process bears any "burden" of proof. If the QCA were satisfied of each of Criterion (a), (b) and (c), it would be expected that the QCA would also be satisfied of Criterion (d) absent countervailing considerations. The Criterion does not require the QCA to undertake a comparison with, or cost benefit comparison of, other forms of regulation. However, such comparisons and cost benefit analyses may be relevant to the assessment of Criterion (d), and the QCA would be required to consider evidence pertaining to such matters if the evidence was probative of the question whether access (or increased access) would promote the public interest.

B. First Question

8. The First Question asks whether the QCA must be satisfied of the Access Criteria for "all parts" of a service before making a recommendation to declare "any particular part" of a service.

9. The First Question arises from the following statements in the Aurizon Submission:

> *"... the QCA review must ensure that all parts of the declared service satisfy the access criteria before making a recommendation to declare any particular part of the service to the Minister. Such a recommendation would require that the QCA reach an affirmative conclusion, based on the application of sound principles to facts, that each distinct service within the declared service met all of the access criteria."*[4]

and

> *"Under section 87A of the QCA Act the QCA must only recommend a service to be declared where the access criteria for any relevant part of the declared services, have been satisfied."*[5]

10. In our view, the foregoing statements in the Aurizon submission are not supported by s 87C of the QCA Act.

11. The relevant power of the QCA to recommend declaration of a service is contained in s 87A(1) of the QCA Act which provides as follows:

> *"At least 6 months, but not more than 12 months, before the expiry date of a declaration of a service, the authority must recommend to the Minister 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."*

12. Section 87C governs the circumstances in which the QCA must, or may, make each of the recommendations identified in s 87A(1). It provides as follows:

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[4] Aurizon Submission, 8.

[5] Aurizon Submission, 38.

> *"(1) The authority must make a recommendation under section 87A(1)(a) if the authority is satisfied about all of the access criteria for the service.*
>
> *(2) The authority must make a recommendation under section 87A(1)(c) if the authority is not satisfied about all of the access criteria for the service.*
>
> *(3) Despite subsections (1) and (2), the authority may make a recommendation under section 87A(1)(b) if the authority is satisfied about all of the access criteria for the part of the service."*[6]

13. Section 87A(1) requires the QCA to recommend declaration of the presently declared service if it is satisfied about the Access Criteria in relation to that service. Under subsection (1), the service is treated as a whole and the Access Criteria are applied to it as a whole. There is nothing in subsection (1) that requires breaking the service up into parts and separate analysis of the Access Criteria in relation to each part.

14. Further, there is nothing in s 87C(3) that suggests that the QCA must be satisfied about the Access Criteria for "all parts" of a service before recommending declaration of "any particular part" of a service.

C. Second Question

15. The Second Question asks whether an assessment of the effectiveness of alternative forms of regulation is relevant to the QCA's assessment of Criterion (a), including price monitoring, potential regulatory intervention and s 46 of the CCA.

16. The Second Question arises from the following passages in the Aurizon Submission (footnotes omitted):

> *"In the absence of access regulation there are substantial constraints on the exercise of market power and the availability of alternate forms of regulation to ensure access is provided on reasonable terms, including:*
>
> - *pricing monitoring of airports, which have similarities to the CQCN given negotiations between large corporate entities with countervailing power, have provided an effective constraint on the prices and returns achieved by airports;*
> - *the threat of regulatory intervention where profits are deemed to be excessive as currently being observed in the Australian Energy Market Commission's*

[6] Section 80(5) of the QCA Act (concerning recommendations by the QCA on request by a person) and s 86(3) of the QCA Act (concerning decisions by the relevant Ministers) are to similar effect; there are no equivalent provisions in Part IIIA of the CCA.

inquiry into the scope of regulation of gas services; and

- *the amendments to section 46 of the CCA which provides for significant penalties for the misuse of market power that lessen competition in any relevant market.*

Taking into account these alternatives there is a limited prospect that access will not be provided on reasonable terms through a commercial negotiation without declaration under the QCA Act."[7]

and

"The QCA should apply the following to its assessment of criterion a):

- *identify the relevant dependent (upstream or downstream) markets;*
- *confirm that the relevant dependent market is separate from the market for the declared services within section 250 of the QCA Act;*
- *assess whether access (or increased access) to the service, by a declaration, which provided for access to be available on reasonable terms and conditions 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 which would or might exist, other than as a result of declaration."*[8]

17. Criterion (a) is contained in s 76(2)(a) of the QCA Act, and reads:

> *"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;"*

18. The current form of Criterion (a) was introduced by the *Queensland Competition Authority Act 2018* (**QCA Amending Act**), which amended the previous criterion.[9] Before those amendments, the previous Criterion (a) read:

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[7] Aurizon Submission, 32.

[8] Aurizon Submission, 34-35.

[9] The previous Criterion (a) under the CCA was contained in ss 44G(2)(a) and 44H(4)(a) of the CCA.

> *"that access (or increased access) to 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;"*[10]

19. As can be seen, the current Criterion (a) retains the same basic structure as the previous Criterion (a). The change made by the QCA Amending Act was to qualify the phrase "access (or increased access) to the service" by inserting the words "*on reasonable terms and conditions, as a result of a declaration of the service*". Decisions on the previous Criterion (a) illuminate the purpose and effect of this amendment. In an early case concerning Criterion (a) under the CCA, the Australian Competition Tribunal (**Tribunal**) interpreted "access" to mean access through declaration, and considered that the application of the Criterion (a) required consideration of the future with and without declaration of the relevant service.[11] However the Full Court of the Federal Court rejected that interpretation, and held that Criterion (a) did not require comparison of the future with and without declaration, but rather:

> *"a comparison of the future state of competition in the dependent market with a right or ability to use the service and the future state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service."*[12]

20. Since Criterion (a) now refers to access (or increased access) "*on reasonable terms and conditions, as a result of a declaration of the service*", it precludes the Full Court's interpretation of the previous Criterion (a). It instead requires an interpretation closer to that previously adopted by the Tribunal. This is confirmed by the relevant extrinsic materials, which identify that the current form of Criterion (a) was introduced following a recommendation by the Productivity Commission that Criterion (a) should become "*a comparison of competition with and without access on reasonable terms and conditions through declaration.*"[13]

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[10] QCA Act, s 76(2)(a), current as at 1 March 2017.

[11] *Re Virgin Blue Airlines Pty Ltd* [2005] ACompT 5 at [163].

[12] *Sydney Airport Corporation Ltd v Australian Competition Tribunal and Ors* (2006) 155 FCR 124 at [83] and [87] to [89] (French, Finn and Allsop JJ); *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* (2017) 253 FCR 115 (***Port of Newcastle Decision***) at [138] per Dowsett, Besanko, Middleton, Foster and Griffiths JJ.

[13] Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66, Canberra (***Productivity Commission Report***), 33 (recommendation 8.1) and 173; Commonwealth of Australia, *Australian Government Response on the National Access Regime* (24 November 2015), 2; *Queensland Competition Authority Amendment Bill 2018 – Explanatory Notes*, at 2. The Commonwealth government's response concerning the National Access Regime identified that the relevant amendment would "re-establish the pre-2006 interpretation of criterion (a)", and that observation was repeated in a draft of the Explanatory Memorandum accompanying the exposure draft of a bill to introduce Criterion (a) in its current form into the CCA (*Exposure*

21. The question whether the relevant access (or increased access) would promote competition requires consideration of the conditions or environment for competition in relevant dependent markets in the future with and without access (or increased access) afforded via declaration.[14] The relevant access (or increased access) would "promote" competition if the conditions or environment for competition would be enhanced in the situation "with" the relevant access compared to the situation "without" that access.[15] The phrase "material increase in" refers to a non-trivial increase.[16] The relevant access would promote a material increase in competition if the future "with" the relevant access would increase the constraints on the market power of suppliers, or increase rivalry among suppliers, in a relevant dependent market in a way that would produce greater efficiency, relative to the situation "without" the relevant access.[17]

22. The Second Question asks us to consider the relevance of "an assessment of the effectiveness of alternative forms of regulation". We understand that "alternative forms of regulation" are forms of regulation that affect the supply of the service referred to in Criterion (a), other than regulation pursuant to declaration under the QCA Act. We have assumed that "effectiveness" is intended to embrace the objectives of Part 5 of the QCA Act, as identified in s 69E – that 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."*

23. Alternative forms of regulation other than declaration under Part 5 of the QCA Act may be relevant to the analysis of Criterion (a), to the extent that such regulation could appreciably affect the analysis of competition in a relevant dependent market in the future with or without access (or increased access). For example, if the CQCN was already subject to a regulatory regime that was producing effective access and effective competition in dependent markets, those circumstances would significantly affect the assessment of

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Draft – Competition and Consumer Amendment (Competition Policy Review) Bill 2016, Exposure Draft Explanatory Materials (**Draft CCA EM**) at [13.18]). However, that observation was not repeated in the *Competition and Consumer Amendment (Competition Policy Review) Bill 2017, Explanatory Materials* (**Final CCA EM**) (see [12.18] to [12.21]).

[14] *Port of Newcastle Decision* at [86] per Dowsett, Besanko, Middleton, Foster and Griffiths JJ. The relevant extrinsic materials refer to an equivalent forward-looking analysis being required under Criterion (a) in its current form: Draft CCA EM at [13.20], Final CCA EM [12.20].

[15] *Re Sydney International Airport* [2000] ACompT 1 at [107], cited in *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2 (**Re Fortescue**) at [1060].

[16] *Re Fortescue* at [583] and [584]; see also *Port of Newcastle Decision* at [144] per Dowsett, Besanko, Middleton, Foster and Griffiths JJ.

[17] *Re Fortescue* at [1061].

Criterion (a). If an alternative form of regulation might become applicable to the CQCN Service in the future, and it could be predicted that that regulation would produce effective access and effective competition in dependent markets, those circumstances may affect the assessment of Criterion (a).

24. The weight to be given to such considerations would be a matter for the QCA, but would be affected by the likelihood that the postulated regulation would be implemented absent declaration under Part 5 and the likely effect of the postulated regulation on competition in dependent markets if implemented in comparison to declaration under Part 5. Relevant factors bearing upon weight would be likely to include:

(a) the history of the regulation of the relevant service, and the likelihood of the alternative form of regulation being applied to the service;

(b) whether the alternative form of regulation would apply to the entire relevant service or part of it;

(c) the extent to which the alternative form of regulation would confer similar rights (eg access rights) to those conferred under the declaration regime;

(d) the extent to which the alternative form of regulation would be available to be used by the same range of users and potential users as under the declaration regime; and

(e) whether rights under the alternative form of regulation could be invoked with comparable ease to those under the declaration regime.

25. While the foregoing matters are all potentially relevant to the assessment of Criterion (a), we would not expect that they would be given significant weight by the QCA with respect to the CQCN Service. There is a substantial body of evidence in Australia that the alternative forms of regulation referred to by Aurizon have not been effective in facilitating access to natural monopoly facilities and curbing the exercise of market power held by owners of natural monopoly facilities. The National Access Regime in Part IIIA of the CCA was introduced as a result of well recognised limitations to section 46 (discussed in the Hilmer Review). Although section 46 has been recently amended, difficulties still exist in the ability of courts to fashion remedial orders that would facilitate access to facilities, including as to the price of access. As shown in the airport context, prices surveillance does not facilitate access or promote competition in dependent markets. At most it affords a degree of price constraint over monopoly services, and in the context of airports, even that constraint has been shown by ACCC reports to be weak. In any event, the CQCN Service is not currently subject to any price monitoring and there is no evidence that it will become subject to any such monitoring in future.

D. Third Question

26. The Third Question asks us to outline the correct approach for the QCA to apply Criterion (d), including the factors that the QCA must or may consider, the relevance (if any) of a cost benefit analysis or other assessment of the efficacy of the current regulatory regime or alternatives to it, the interpretation of the words "would promote the public interest", and the level of satisfaction the QCA must attain to be "satisfied" within the meaning of s 76(1)(a) of the QCA Act.

27. The Third Question arises, in part, from the following question identified in the QCA Questions:

> *Stakeholders are invited to comment on the extent to which an assessment of the effectiveness of the current regulatory regime[18] (including a cost versus benefits comparison) is relevant to the QCA's assessment of criterion (d)?*

28. The Third Question also arises from statements in the Aurizon Submission which suggest that Criterion (d) requires an analysis of costs and benefits from access regulation through declaration compared to alternative forms of regulation, and that the QCA must have a high degree of satisfaction of the Access Criteria for the purposes of s 76(1)(a). The following are some examples:

> *'The best evidence of the fact that declaration... would not result in promotion of the public benefit is founded in the results of regulated access under the existing declaration."*[19]
>
> *"The QCA and the Minister must be satisfied with a high degree of confidence that declaration is needed to ensure access to the CQCN in a manner that will achieve economic efficiency, so as to promote the public interest."*[20]
>
> *"... the amendment to the access criteria that requires declaration to be in the public interest ... imposes a positive obligation on the QCA to demonstrate that a recommendation to declare part, or all, of the service will result in improved outcomes for society relative to the potential alternatives."*[21]
>
> *"Criterion d) requires a demonstration that the costs of regulation are outweighed*

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[18] Including the approval and administration of access undertakings.

[19] Aurizon Submission, 4.

[20] Aurizon Submission, 5.

[21] Aurizon Submission, 13.

by any benefits".[22]

"... the public interest assessment requires a consideration of the relevant costs imposed by the current system of regulation be properly assessed. Those costs, including productive and dynamic inefficiencies, must not exceed the allocative efficiency benefits."[23]

"... there are substantial costs from declaration under the QCA Act and those costs materially exceed the expected benefits from increased allocative efficiency. These costs are largely associated with the design and performance of the current regulatory framework. The public interest could only be satisfied where the net costs of regulation are substantially reduced through less prescription, increased incentives to invest and less commercial and regulatory rigidity to support increased coordination and supply chain efficiency. An alternate approach to regulation must be considered, as declaration under the current regulatory model does not satisfy the public interest requirements of the QCA Act."[24]

29. Criterion (d) is contained in s 76(2)(d) of the QCA Act, and reads:

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

30. Further, s 76(5) of the QCA Act provides:

"*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

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[22] Aurizon Submission, 14; see also similar comments on 15.

[23] Aurizon Submission, 17; see also other similar statements on that page.

[24] Aurizon Submission, 33.

provider of the service if the service were declared;

(d) any other matter the authority or Minister considers relevant."[25]

31. The current form of Criterion (d) was introduced into the QCA Act by the QCA Amending Act. Prior to those amendments, the equivalent criterion was contained in s 76(2)(e) of the QCA Act,[26] and read:

> *"that access (or increased access) to the service would not be contrary to the public interest".*

32. Prior to the amendments made by the QCA Amending Act, s 76(3) of the QCA Act identified nine matters to which the QCA and Minister were required to have regard when applying the previous public interest criterion. The QCA Amending Act repealed that list, and replaced it with s 76(5).

33. Criterion (d) now requires that the QCA be positively satisfied that the relevant access "would promote the public interest". It would not be sufficient for the QCA to be satisfied that the relevant access would "not be contrary to", or would be neutral as to, the public interest. The extrinsic materials regarding the introduction of Criterion (d) state that it was intended to address a concern that the previous public interest criterion had set too low a hurdle for declaration.[27]

34. The meaning of the phrase "the public interest" was considered by the High Court in the context of the previous public interest criterion in the CCA in *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379 (***Pilbara HC Decision***). The High Court observed that the phrase permits a very broad factual inquiry (footnotes omitted):

> *"It is well established that, when used in a statute, the expression "public interest" imports a discretionary value judgment to be made by reference to undefined factual*

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[25] Section 76(5)(a) is substantially similar to the previous s 76(3)(i) of the QCA Act, and has no equivalent under the CCA. Sections 76(5)(b) and (c) are comparable to the equivalent provisions in s 44CA(3) of the CCA: s 76(5)(b) is similar to s 44CA(3)(a), save that the CCA refers to the effect of declaring the service on investment in "infrastructure services" rather than "facilities"; s 76(5)(c) is similar to s 44CA(3)(b), but concludes with the words "if the service is declared" rather than "if the service were declared". Section 76(5)(d) has no equivalent under the CCA. Section 44CA(3) of the CCA was introduced following a recommendation by the Productivity Commission that the National Competition Council and Minister "*should be required to have regard to the effect of declaration on investment in markets for infrastructure services and dependent markets, and administrative and compliance costs*" when considering whether the relevant access would promote the public interest: Productivity Commission Report at 33, (recommendation 8.4), and 180 – 181.

[26] The previous form of Criterion (d) under the CCA was contained in ss 44G(2)(f) and 44H(4)(f) of the CCA. There was no provision comparable to the current s 76(5) of the QCA Act, or the previous s 76(3) of the QCA Act, under the CCA before Criterion (d) was introduced in its current form.

[27] Productivity Commission Report at 178 – 179; Commonwealth of Australia, *Australian Government Response on the National Access Regime* (24 November 2015), 6.

> *matters. As Dixon J pointed out in Water Conservation and Irrigation Commission (NSW) v Browning, when a discretionary power of this kind is given, the power is "neither arbitrary nor completely unlimited" but is "unconfined except in so far as the subject matter and the scope and purpose of the statutory enactments may enable the Court to pronounce given reasons to be definitely extraneous to any objects the legislature could have had in view".*[28]
>
> ...
>
> *"Because so many different kinds of consideration may be relevant to an assessment of what is "contrary to the public interest", many if not all of those matters which can be described as "social costs" could be relevant to that assessment. And the significance to be attached to such social costs would, no doubt, be affected by the existence of any countervailing social benefits."*[29]

35. The breadth of the phrase "the public interest", and the matters that may be considered under it, is reflected in the range of matters identified in s 76(5) of the QCA Act. The relevant extrinsic materials confirm that the introduction of s76(5) was intended to simplify Criterion (d), but still to permit the QCA and Minister to have regard to any of the nine matters previously identified in s 76(3) that they considered to be relevant.[30]

36. It may also be assumed that the stated objects of Part 5 (contained in s 69E) are consistent with the public interest, and that promotion of the objects of Part 5 also promotes the public interest. It follows that, if in a given matter the QCA were satisfied of Criterion (a), (b) and (c), the QCA would also be satisfied that access via declaration promotes the public interest to that extent. That is not to say that satisfaction about Criterion (a), (b) and (c) gives rise to a presumption that access via declaration would promote the public interest.[31] It is simply to observe that, if the QCA is satisfied of Criterion (a), (b) and (c), it will at least be satisfied of economic benefits from access (or increased access) that are consistent with the objects of Part 5 and thereby promote the public interest: specifically the promotion of competition in a dependent market (under Criterion (a)), or the potential for costs savings from access (identified under Criterion (b)). It is then for the QCA to consider whether there is evidence of other likely or potential consequences of access (or increased access) that affect the

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[28] *Pilbara HC Decision* at [42] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ.

[29] *Pilbara HC Decision* at [111] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ.

[30] *Queensland Competition Authority Amendment Bill 2018 – Explanatory Notes*, at 6.

[31] Final CCA EM at 15, [1.1].

assessment of the public interest,[32] either positively or negatively, and to form an overall assessment.[33]

37. Given the broad nature of the phrase "the public interest", and the terms of s 76(5) of the QCA Act, the range of matters that may bear on the QCA's analysis is "very wide indeed".[34] The QCA must have regard to the matters in s 76(5)(a) to (c), and to any other matters that it consider relevant (under s 76(5)); those other matters could include any social and environmental costs and benefits from access (or increased access)[35], and other matters that the QCA considered relevant.

38. As discussed above, the QCA's decision whether to recommend declaration of the CQCN Service arises under s 87A of the QCA Act, and that decision is governed by the requirements of s 87C. Relevantly, the QCA must decide whether it is "satisfied" about the Access Criteria. In that respect, section 87C uses the same language as s 76(1)(a). The QCA is an administrative body, and as such, no "standard of proof" applies to its decisions. The QCA is not, for example, required to be satisfied on the balance of probabilities, or beyond reasonable doubt. The use of the word "satisfied" requires that the QCA feel some level of persuasion of each of the Access Criteria before recommending declaration of the CQCN Service.[36] The QCA Act does not otherwise require that the QCA attain any "high" or other particular degree of confidence regarding its conclusion under Criterion (d). Consistent with the administrative nature of the QCA's task, there is similarly no burden of proof on any participant in the QCA's process, or requirement that any such participant "demonstrate" any matters in order for the QCA to be satisfied of Criterion (d) or any of the other Access Criteria.[37]

39. Given the breadth of the phrase "the public interest", it is generally a matter for the QCA what matters it will consider or investigate for that purpose. However, s 76(5) sets out a

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[32] *Application by Glencore Coal Pty Ltd* [2016] ACompT 6 at [170], [172].

[33] It would be inconsistent with the QCA having reached a conclusion on whether it was satisfied about those other Access Criteria for Criterion (d) to be used to re-open or call into question the QCA's analysis of those criteria. However, subject to that qualification, the QCA should have regard to any relevant matters considered under those other criteria when applying Criterion (d).

[34] *Pilbara HC Decision* at [42] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ.

[35] *Pilbara HC Decision* at [111] per French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ; Final CCA EM, 15 to 19.

[36] *Plaintiff M64/2015 v Minister for Immigration and Border Protection* (2015) 258 CLR 173 at [64] per Gageler J. Also see *Application by Glencore Coal Pty Ltd* [2016] ACompT 6 at [53], citing *Re Telstra Corporation Ltd* (2006 ATPR 42-121 at [20], [46] and [172].

[37] *Application by Glencore Coal Pty Ltd* [2016] ACompT 6 at [53], citing *Evans v Secretary, Department of Families, Housing, Community Services and Indigenous Affairs* (2012) 289 ALR 237 at [18] per Rares, Buchanan and Griffiths JJ.

number of mandatory considerations that must be taken into account by the QCA. Relevantly, they include the effect of declaration on investment in facilities and dependent markets and the administrative and compliance costs that would be imposed on the service provider by declaration. Otherwise, the QCA is to consider any other matter that it considers to be relevant.

40. We have been asked to identify the relevance to Criterion (d), if any, of an assessment of the effectiveness of the current regulatory regime (including the approval and administration of undertakings) or alternative forms of regulation (including price monitoring, potential regulatory intervention, and s 46 of the CCA). We have also been asked to consider the relevance to Criterion (d), if any, of a cost benefit comparison of the current regulatory regime to alternative regimes. We interpret the phrase "alternative regulatory regime" and the word "effectiveness" in the manner described above.

41. Criterion (d) requires a forward looking assessment of whether access (or increased access) via declaration would promote the public interest. This requires consideration of any benefits or detriments arising from access (or increased access) through declaration which may bear on the public interest. Such consideration inherently invites a comparison to the relevant market environment without access. As such, if there was evidence that the current regulatory regime had not been effective, in the sense that it was not achieving the objects of Part 5, or was imposing costs that outweighed the benefits of access, such evidence would be relevant to the QCA's assessment of Criterion (d). We emphasise, though, that there is a difference between mere assertion and evidence. The QCA would be entitled to dismiss mere assertion as irrelevant.

42. Similarly, if there was evidence that an alternative form of regulation could be expected to deliver equivalent benefits to access via declaration, but at lower overall cost to market participants, such evidence may be relevant to the QCA's assessment of Criterion (d). We observe, though, that Criterion (d) does not require the QCA to be satisfied that access via declaration is the best means of promoting the public interest – it only requires the QCA to be satisfied that access via declaration promotes the public interest. The fact that an alternative regime may better promote the public interest does not foreclose the QCA being satisfied of Criterion (d). It can be acknowledged though, that if an alternative form of regulation was in existence or certain to be implemented, and it had demonstrably better economic outcomes compared with access via declaration, and it could be shown that access via declaration would detract from those economic outcomes, it would be open to the QCA to conclude that access via declaration would not promote the public interest.

43. In relation to the relevance of alternative forms of regulation, our earlier observations

concerning Criterion (a) are also applicable here. The weight to be given to the consideration of alternative forms of regulation would be a matter for the QCA, but would be affected by the likelihood that the postulated regulation would be implemented absent declaration under Part 5 and the likely effect of the postulated regulation on competition in dependent markets if implemented in comparison to declaration under Part 5. For the reasons expressed earlier, we would not expect that the possible costs and benefits of alternative forms of regulation would weigh significantly in the QCA's assessment of the CQCN Service.

Date: 16 July 2018

MICHAEL O'BRYAN QC

Ninian Stephen Chambers

ALICE MUHLEBACH

Isaacs Chambers

Attachment 2 – RBB Expert Report

RBB Economics

Economic matter relevant to the regulation of the CQCN

Response to initial Aurizon submission

RBB Economics, 16 July 2018

1 Introduction and summary

1 I have been retained by Herbert Smith Freehills to act as an independent expert in relation to the consideration of economic matters raised in the initial submissions made in response to the assessment of the declaration of the Central Queensland Coal Network (**CQCN**) which is owned by Aurizon Network Pty Ltd (**Aurizon Network**).

2 The questions that I have been asked to address are set out in the engagement letter, which I have included in Annex B of this report. In particular, I have been asked to address the following issues:

- the economic rationale for access regulation, particularly in relation to the regulation of below-rail infrastructure such as the CQCN;
- the constraints that would operate on and the incentives faced by Aurizon Network if the CQCN was not subject to declaration;
- the countervailing power of above-rail providers and other access seekers if the CQCN was not subject to declaration;
- the likely prices experienced by above-rail providers and other access seekers if the CQCN was not subject to declaration and the associated impact of such prices on dependent markets;
- the impact on productive, allocative and dynamic efficiency if the CQCN was not subject to declaration; and

- if the Newlands and/or the Moura systems were not subject to declaration, the likelihood that any lost production, investment and employment from that/those systems would be replaced by new or increased production, investment and employment (from another CQCN system or otherwise).

1.1 Overview of my experience

3 I am a Partner with RBB Economics, based in Melbourne. I joined RBB Economics in July 2009 and specialise in the application of economics to competition and regulatory issues across a range of industries including telecommunications, retailing, agriculture, manufacturing, logistics, and financial services. In that time I have advised on many of the most contentious mergers before the ACCC since RBB Economics was established in Australia in 2009 and have presented expert evidence before the Australian Competition Tribunal.

4 Prior to joining RBB, I worked for Telstra where I helped determine prices both in regulated wholesale markets as well as in competitive retail markets. I also worked as an economic consultant in the UK for eight years where I developed and led the communications practice at Europe Economics and began my career at the Productivity Commission (formerly the Industry Commission) in their Canberra and Melbourne offices where I was awarded the Commission's first Overseas Development Award.

5 While at RBB Economics, I have recently advised Brookfield Rail (now Arc Infrastructure) on the economic considerations on pricing a rail access service and appeared as an expert witness during an arbitration between Brookfield Rail and CBH. I also advised Genesee & Wyoming (Australia) during an inquiry by the Essential Services Commission in South Australia into whether the revenues charged for (below-rail) access to its Adelaide to Darwin railway were excessive and advised Asciano on the appropriate methodology that the regulator in NSW should use to set access prices for rail services provided by Patrick at Port Botany.

6 I hold a Bachelor of Economics (Honours) and a Masters of Law (Juris Doctor) from Monash University. I have included in Annex A of this report a copy of my curriculum vitae.

1.2 Summary of my findings

7 Declaration enables access seekers to gain access to significant infrastructures where there may be a lack of effective competition. Declaration allows two competition goals to be achieved.

8 First, it can help ensure that competition in downstream markets is protected where the infrastructure provider is also active in the downstream market alongside third party suppliers. In this report, I refer to this issue as the "downstream problem" as it deals with competition in downstream markets.

9 The downstream problem arises in this case because Aurizon Network operates the below-rail network *and* Aurizon Operations offers above-rail services (rail haulage services) to

miners.[1] Third-party rail haulage suppliers may, therefore, compete with Aurizon to supply above-rail services to miners, but only if they gain access to Aurizon's infrastructure.

10 The potential for competition to be distorted in the rail haulage market in this case is clear. By refusing to provide access to third-party rail haulers, or by charging exploitative prices for access to its network to those third-party suppliers, Aurizon Network can prevent competition for rail haulage services from taking place, and instead reserve the rail haulage service for its own (integrated) operations. The effect of that is to lessen the rivalry at the rail haulage part of the supply chain causing the prices paid by miners for rail haulage to increase. The margins earned by Aurizon's rail haulage business will be increased as a result.

11 Second, even if there is not a risk of a differential treatment of downstream competitors, and consequently of those competitors being foreclosed, declaration can prevent the infrastructure provider from charging an excessive price for access, which could also distort competition in related markets.

12 I refer to this problem as the "monopoly problem" and it relates to the ability of Aurizon Network, absent declaration, to charge inflated prices and derive excessive profits at the expense of miners and possibly of economic efficiency if no commercially attractive substitutes are available to miners to transport their coal from their mines to the port. In other words, even if Aurizon Network was not vertically integrated – that is, even if it did not compete in the rail haulage market with third party suppliers of rail haulage – there is still an economic problem which declaration addresses.

13 Aurizon Network has argued that the costs of regulation exceed the benefits from addressing the downstream problem and the monopoly problem that I discussed above. It is not clear whether that claim refers to costs and benefits from the perspective of Aurizon Network or from a broader welfare perspective. I would expect that the costs of regulation may fall more heavily on Aurizon Network, but that does not mean that there is not a net benefit to society from regulation.

14 If Aurizon Network is arguing that the costs of declaration exceed the benefits for society as a whole, then that claim is not supported by observed market evidence nor by the literature that Aurizon Network has pointed to in its submission.

15 With respect to the downstream concern, Aurizon Network acknowledges that third party entry into the rail haulage market in central Queensland has coincided with substantial productivity improvements into that market, but claims that those improvements have come at too high a price and led to an efficiency loss from coordinating multiple users of rail infrastructure and the associated transaction costs associated with vertical unbundling.

16 No attempt has been made by Aurizon Network to quantify those costs and although declaration may impose costs on the infrastructure service provider, these types of costs are typically considered worth incurring in order to secure the dynamic benefits of rivalry in

[1] Any reference to Aurizon Network in this report includes Aurizon Operations when referring to the above-rail part of the supply chain.

downstream markets. In this case, those costs, which will be borne more heavily by Aurizon Network, are required in order to deliver benefits, including lower prices to third party rail haulers and to miners using rail haulage services.

17 Whether or not those costs exceed the benefits from the society as a whole is ultimately an empirical question. But rather than present evidence on the costs (and benefits) of declaration, Aurizon Network relies on a brief literature review to claim that the industrial organisation literature for railways has generally concluded that the optimally efficient market structure for railways is vertical integration. However, one of the studies that Aurizon Network actually relies on to make that claim flatly contradicts it and finds instead that there is no clear view about the optimal structure of railway networks. For example, that study finds that the optimal market structure will depend on train density and that vertical separation tends to *reduce* the total costs of a railway network when train density is relatively low.

18 Aurizon Network also argues that light-handed regulation that relies on commercial negotiation should be the preferred model used for regulating access to the CQCN. Its view is the countervailing power of miners will provide adequate protection against any market power that Aurizon Network may have.

19 The preferred model for regulating access to the CQCN will need to have regard to the extent to which Aurizon Network's below-rail operations are subject to effective competitive pressure, either from existing assets already competing at the below-rail level, or from the threat that such assets might be created. My understanding is that there are no viable or attractive commercial alternatives to the below-rail service, which is a sign that competition cannot be expected to operate in the below-rail part of the market. As a result, declaration will be needed to prevent Aurizon Network from refusing to provide access to third party rail haulage operators on reasonable terms or from charging excessive prices to miners.

20 Finally, I would not in this case expect a light-handed regime and a reliance on commercial negotiation to achieve an outcome that is consistent with a (workably) competitive market. The reason for this is that the price that would result from such a negotiation would depend on the outside options available to each party. The only remotely plausible alternatives to the Aurizon Network in this case are other rail networks or the use of road transport options to haul coal. I understand that these options are limited. Consequently, any commercial negotiation in the absence of a regulatory safety net cannot be expected to achieve an outcome that is consistent with a (workably) competitive market.

2 Q1: The economic rationale for access regulation, particularly in relation to the regulation of below-rail infrastructure such as the CQCN

21 The objective of third party access declarations was set out clearly in the Queensland Competition Authority's (QCA) Staff Issues Paper and relates to the need to provide a regulatory framework to enable access seekers (users) to gain access to significant

infrastructure services (on appropriate terms) where market competition may not be sufficiently effective to ensure that such access is made available.[2]

22 While the QCA's Staff Issues Paper sets out in detail 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, the economic rationale for access regulation is relatively straightforward. In some situations, the desire for effective competition in a related market requires competitors to have access to facilities which exhibit natural monopoly characteristics, and which cannot (and should not) be duplicated economically.

23 This gives rise to two related economic concerns – a "monopoly" concern and a "downstream" concern. I explain each of these below, but first define what I mean by the terms "monopoly" and "downstream" in the context of the potential declaration of the CQCN.

24 The *monopoly* concern refers to the potential for Aurizon Network to charge a monopoly price to users of the below-rail network, which I understand to be a natural monopoly. The *downstream* concern is closely related to the monopoly problem but specifically deals with the problems caused by the lack of access (or lack of access on reasonable terms) in a related market that relies on access to the below-rail network. The primary market that I discuss in this report is the market for rail haulage.

25 Aurizon Network currently also offers rail haulage services alongside third party rail haulage suppliers. In other words, it is vertically integrated – meaning that it operates both in the below-rail market and the downstream market. Critically, all rail haulage operators rely on Aurizon Network's infrastructure in order to provide their services. Whenever a service provider is vertically integrated with a supplier that holds a position of significant market power on an input market, there is clear potential for it to distort the terms on which rivals can access the input in question in order to affect competition on the downstream markets, to the benefit of its own downstream operations. Given that Aurizon Network is vertically integrated and controls essential infrastructure, there is a strong case for intervention to ensure that it does not favour its own rail haulage business.

2.1 Downstream concerns

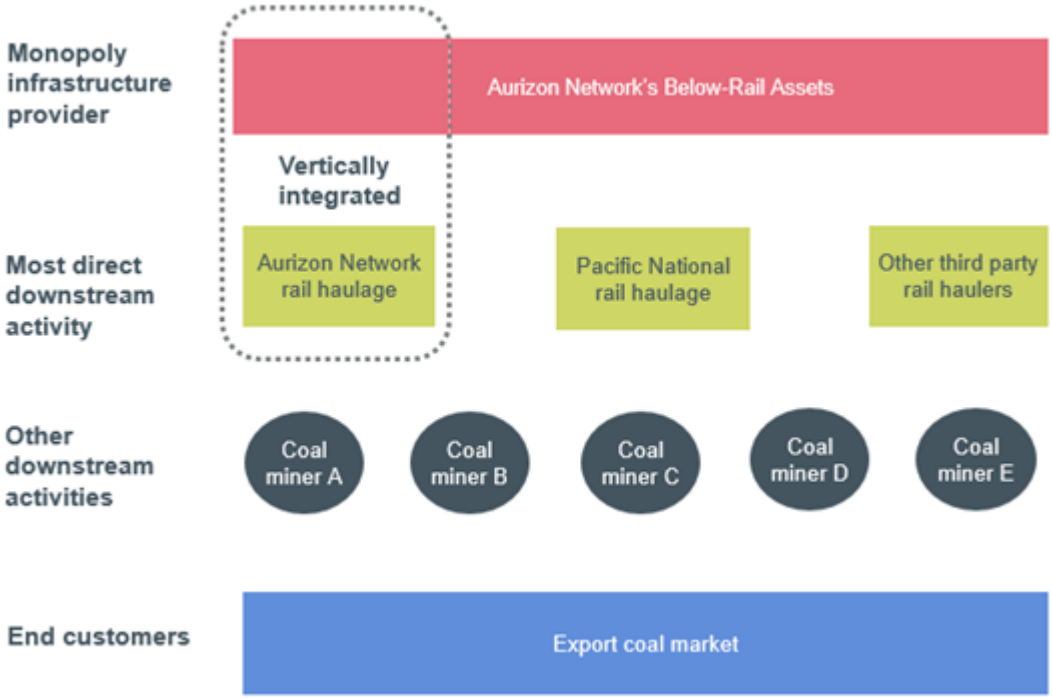
26 The downstream concern arises when access to the below-rail natural monopoly element is essential for effective competition in the downstream activity. In such circumstances, if the vertically-integrated below-rail monopolist chooses not to provide effective access to third parties, it can prevent competition from taking place in the downstream activity, instead reserving the downstream activity for its own (integrated) operations. Hence, even though that downstream activity has the potential to be competitive, prices to miners may be raised above competitive levels in practice, on account of the restricted third-party access that is available to the natural monopoly, below-rail services.

[2] Queensland Competition Authority, Staff Issues Paper, "*Declaration reviews: applying the access criteria*", April 2018, p.1

27 In other words, the vertically-integrated below-rail monopolist is also able to limit competition for potentially competitive downstream services markets by restricting third-party access to below-rail services, thereby raising the prices paid by miners for downstream services.

28 This concern can be illustrated in Figure 1 where Aurizon Network's refusal to provide access (or access on reasonable terms, at least) prevents third party rail haulage operators from entering (or effectively competing in) the downstream market. This reduces the choices of miners operating along the CQCN, and protects Aurizon Network's own rail haulage operation from competition and thus keeps prices for rail haulage above workably competitive levels.

Figure 1: The below-rail network and related downstream markets in the CQCN



29 This downstream concern is at the heart of the national access regime in Australia, which can be traced back to the report of the Hilmer Committee in 1993[3], and which was intended to apply to those facilities "that exhibit natural monopoly characteristics, in the sense that they cannot be duplicated economically". The Hilmer Committee provided examples of effective competition in electricity generation requiring access to electricity transmission grids - the integration of the natural monopoly element (transmission grids) and a potentially competitive activity (electricity generation) raises concerns that control over access to the monopoly element may be used to stifle or prevent competition in the potentially competitive (downstream) sector. The Hilmer Committee argued that, even if access is not actually misused, the *potential* for such behaviour may deter new entry to, or limit vigorous competition in, markets dependent on access to the natural monopoly element.

[3] Hilmer Committee (Independent Committee of Inquiry into Competition Policy in Australia) 1993, *National Competition Policy,* Australian Government Publishing Service, Canberra.

2.2 Monopoly concern

30 In the case where the owner of an essential facility does not compete in the potentially competitive ("downstream") activity, the Hilmer Committee argued that the owner of the facility would have little incentive to deny access to firms operating in those markets as competition in vertically related markets maximises its own profits. But the Committee noted that "like other monopolists, however, the owner of the facility is able to charge higher prices and derive monopoly profits at the expense of consumers and economic efficiency".[4] Such a price could also potentially affect competition in related markets.

31 The monopoly concern can also be shown in Figure 1. In that case, the monopoly concern arises because the "below rail" service is a natural monopoly and the "above rail" or rail haulage service is competitive. In that case, allowing the below rail operator to charge a "monopoly" price would be inefficient if it meant the below-rail provider restricted the services it provides. That reduction in services (compared to the services that would be provided if price was set at the level of marginal costs) is referred to as a "deadweight" or static allocative efficiency loss.

2.3 Response to Aurizon Network's comments

32 Aurizon Network argues that a "fundamental premise of the review of the declaration is that access regulation must be affirmatively demonstrated to be welfare enhancing, and that without regulated access on reasonable terms the output from the CQCN would be lower than it would be with declaration."[5] It goes on to list two conditions that must be satisfied for access regulation to produce those benefits:

- First, the infrastructure owner, or the vertically integrated operator, would have an incentive to deny access.
- Second, the demand for coal carrying train services is relatively elastic such that there would be a corresponding reduction in demand associated with either:
  - A price which materially exceeds the long-run marginal cost of the service; or
  - X-inefficiency arising from lack of innovation and productivity improvements.

2.3.1 Does Aurizon Network have an incentive to deny access?

33 Aurizon Network did not explain why it submits that it will lack the incentive to deny access and appeared to rely on some of the arguments made by the Productivity Commission in its review of the national access regime five years ago.

34 However, the references that Aurizon Network made to that review are not strictly relevant to the question of the declaration of the CQCN. In particular, Aurizon Network relies on the following reference from the PC:

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4 Ibid, p 241.

5 Aurizon Network Submission – *Review of Declared Services in the Central Queensland Coal Network* ("**Aurizon Network submission**"), p.12.

> *"Intervention to require access where the infrastructure service provider has no ability to affect prices in downstream markets risks lowering efficiency and, in the long term, adversely affecting incentives to invest in markets for infrastructure services".*[6]

35 The relevance of this extract to the current matter is unclear for three reasons.

36 First, even if the price of the affected downstream market is set by reference to global prices, total welfare could still be reduced if the monopoly access price displaced more efficient output from the CQCN with less efficient output from other sources.

37 Second, the PC's observation does not strictly apply in the current matter because it applies to the case where the price of the affected downstream market is set by reference to global prices and the users of the infrastructure service are price takers.

38 That is not the case in this matter for the rail haulage market. The current declaration relates to a market where Aurizon Network is the below-rail (natural) monopolist and can clearly affect prices in the most immediate downstream market, which is the rail haulage market. In other words, the downstream problem can be described as follows: the below-rail operator also operates its own rail haulage service to miners on its below-rail network and could refuse to supply rail access to third party rail haulers that wished to compete with Aurizon's own rail haulage service. Such a refusal to provide access to third party rail haulers could preclude any possibility that these third party rail haulers could compete in this market at all.

39 The effect of that conduct would be that prices for rail haulage would increase as a result of the loss of rivalry. Indeed coal miners may pay up to the monopoly price to get their coal from their mines to the port as a consequence. That outcome would happen *irrespective* of the fact that the users of the infrastructure service are price takers in the downstream export coal market and is a direct result of the reduction of rivalry at the rail haulage level of the supply chain.

40 Third, monopoly pricing may have further implications for other downstream markets – such as the market for metallurgical or thermal seaborne coal which I discuss later – but the ability of Aurizon Network to affect prices in the rail haulage market does not appear to me to be in dispute.

41 The view that monopoly pricing may cause competitive harm even if it does not lead to a reduction in the volumes carried by the below-rail infrastructure operator was clearly expressed by the Chairman of the ACCC in 2016:[7]

> *Some commentators on the economic regulation of monopoly or near monopoly infrastructure have argued that any monopolistic pricing amounts to a pure transfer of economic rents between parties within the supply chain. That is, the transfer of economic rents between parties within*

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6 Aurizon Network submission, p.12.

7 Speech by Rod Sims, Chairman, ACCC "*Ports: What measure of regulation*" delivered to the Ports Australia Conference, Melbourne 20 October 2016.

> *a commodity export supply chain could occur without any impact on the production or investment decisions of users.*
>
> *Such an argument defies all economic teaching that monopolists charge more and give less.*
>
> *It also fails to consider the potential harmful impacts on investment and innovation in upstream or downstream industries.*
>
> *One needs to understand that, in order to produce or extract a commodity like coal, this requires a major sunk investment in mining equipment and infrastructure. These sunk investments give rise to what are known as "quasi-rents" which are subject to the threat of hold-up.*
>
> *The threat of expropriation of rents by a monopoly service provider in such a situation would only in extreme circumstances result in a pure transfer. More likely, even the threat of such expropriation can limit future investment and innovation by the upstream firms.*
>
> *What miner would invest in reducing its extraction costs if it knew that the lower extraction costs would simply be met by higher port charges? More generally, what miner would invest in its mines knowing that the benefits of that investment could be expropriated by a monopoly somewhere else in the supply chain?*
>
> *My point here is a simple one. To say we shouldn't be concerned about monopoly pricing because it is merely a transfer of economic rents is wrong in economic and commercial logic.*

42 The relevance of these comments to the present case is that they indicate that even if Aurizon Network lacks the incentive to deny access to its below-rail network, the price that it charges to access seekers could still distort competition and lead to inefficiencies. In other words, the QCA should be concerned that monopoly prices could distort competition and efficiency in other markets even if they do not lead to a reduction of allocative efficiency in the below-rail market (that is, even if rail haulage operators do not reduce their usage of the below-rail service).

2.3.2 Is the demand for coal carrying train services "relatively elastic"?

43 When assessing the monopoly concern, Aurizon Network suggests that the deadweight loss from monopoly pricing is likely to be low if demand for coal carrying train services is relatively inelastic. Presumably, the reason for this is that rail haulers will still require access to provide services to their customers and would not reduce their demand materially in response to a price change.

44 That claim can be tested with observed market data, although disappointingly, Aurizon Network does not provide any evidence on the elasticity of demand over its below rail network. I do note, however, that in support of its claim that the uniform pricing imposed by the

regulatory regime is inefficient, it argues that mines vary greatly in their ability to bear fixed costs associated with the provision of rail lines or network. Aurizon Network argues that there may be mines that would only be viable if they were to bear only the incremental costs of servicing their needs.[8]

45 The claim that mines vary greatly in their ability to bear fixed costs associated with the provision of rail lines or network suggests to me that demand for the services provided over Aurizon Network's below-rail network is likely to be somewhat elastic. This means that an increase in the price of the below-rail service in the absence of declaration may lead to a reduction in output if some mines are not able to bear higher rail haulage charges and which may lead to the allocative inefficiency that access regulation is designed to avoid.

46 However, as discussed above, monopoly prices could distort competition and efficiency in other markets even if rail haulage operators choose not to reduce their usage of the below-rail service.

2.4 Summary of response to question 1

47 Access regulation in this case is needed to deal with two related economic problems – a downstream competition problem as well as a monopoly problem.

48 The downstream competition problem arises when Aurizon Network chooses not to provide access to its below-rail network on reasonable terms, thereby preventing competition from taking place in the rail haulage market. Miners will be harmed because the loss of rivalry at that level of the supply chain will mean that they pay more to transport their coal from their mines to the port. When the rail operator is vertically integrated there is likely be a stronger case for intervention to ensure that the rail operator does not favour their own rail haulage service.

49 Access regulation is also needed to deal with the monopoly problem, which relates to the incentive that a natural monopolist below-rail operator has to raise the price of rail haulage charged to miners to the monopoly level. Monopoly prices could distort competition and efficiency in other markets even if they do not lead to a reduction of allocative efficiency in the below-rail market.

3 Q2: The constraints that would operate on and the incentives faced by Aurizon Network if the CQCN was not subject to declaration

50 On page 9 of its submission, Aurizon Network states the following:

> *"In conceiving of the market without any declaration, the QCA must consider whether the public interest and economic efficiency could be substantially enhanced by an alternative approach to regulation which is*

[8] Aurizon Network submission, p,16.

> *less prescriptive and facilitates negotiated settlement with a primary emphasis on monitoring and enforcement under existing powers".*

51 Aurizon Network goes on to argue that:

> *"…the QCA should not seek to assess whether a substitute for the service delivered currently exists in determining whether the market for the service is contestable. Rather it should evaluate whether the conditions exist for users to exercise countervailing market power or to promote entry and competition".*

52 I believe that it is artificial to separate the question of whether a substitute for the service currently exists on the one hand and the conditions that exist for users to exercise countervailing power on the other hand. This is because the countervailing power of the users of the network will depend on the extent to which a substitute for the service currently exists, that is the extent to which they could bypass the network (as well as the extent to which they could credibly threaten to sponsor a new network).

53 If the CQCN was not subject to declaration, then I would expect the terms and conditions of access, including price, to be determined through negotiation between Aurizon Network and the users of the below-rail network. The critical question, however, is whether the price that results from those negotiations is one that is consistent with (workable) competition.

54 In my opinion, even if the below-rail network is a natural monopoly, the price that would result from such a negotiation would depend on the outside options available to each party. For the users of the below-rail network, the strength of those outside options would depend on the availability of suitable rail or non-rail alternatives for hauling coal.

55 The following simple, hypothetical example can explain how the outside option will determine prices in the market. Assume that the short run marginal costs associated with providing below-rail services are $1/MT and the monopoly price is $10/MT. The price of using another rail or road alternative is $7/MT.

56 In that example, the price that would result from a commercial negotiation is $6.99/MT. That is the point at which Aurizon Network's below-rail network is (just) cheaper than the next best alternative and would be the price that Aurizon Network would offer to the users of its below-rail network. In this simple example, the availability of alternative and viable rail haulage options act as a binding commercial constraint on Aurizon Network's ability to charge the monopoly price of $10/MT. Any price above $7/MT would lead to volumes being displaced from the CQCN and transported using alternative options.

57 And even though the price paid by miners of $6.99/MT is above the short-run marginal cost of using the network, and therefore, above the theoretical perfect competition benchmark, I would still describe that price as consistent with workable or effective competition.

58 I do not believe that the miners using the CQCN would be able to transport their coal via other existing rail networks. Moreover, I do not believe that construction of a duplicate rail network

would be at all plausible. If alternative rail services are not plausibly available, as I believe is the case, the negotiating strength of the below-rail network users will, therefore, depend more specifically on the availability of road transport options.

59 Hence, I would expect that the price for rail access struck following any negotiation between Aurizon Network and its haulage (or mining) customers would be constrained by the price of hauling coal by road. The more or less attractive the option of hauling coal by road to the miners, the better or worse the terms that I would expect users of the below-rail network to secure from Aurizon Network as a result of commercial negotiation absent declaration.

60 My understanding is that road transport is not a viable commercial option for miners. This means that the outside options available to miners – and consequently to other above-rail haulers – are limited or, effectively, non-existent. If there are no realistic prospects of alternative options emerging, then the prospects of commercial negotiation delivering a reasonable outcome in the absence of a regulatory safety net will be similarly limited. In other words, commercial negotiation in this case is unlikely to lead to a price that is consistent with workable competition and is more likely to lead to a price that reflects Aurizon Network's monopoly position in providing below-rail services.

61 This means that Aurizon Network's call to separate the question of whether substitutes to the above-rail service exist and the question of whether the conditions exist for users to exercise countervailing power will not result in meaningful additional market constraints on prices for rail access being identified.

3.1 Summary of response to question 2

62 If the CQCN was not subject to declaration, then I would expect the access price to be determined through negotiation between Aurizon Network and the users of the below-rail network. There are no realistic prospects of competition emerging in the below rail market and no viable non-rail alternatives to transport coal from their mines to port. As a result, the outcome of any commercial negotiation is likely to lead to a price that reflects Aurizon Network's monopoly position in the provision of below-rail services.

4 Q3: The countervailing power of above-rail providers and other access seekers if the CQCN was not subject to declaration

63 I discussed the role that the countervailing power of above-rail operators plays in determining the access price in the answer to the previous question.

64 To summarise, the QCA cannot separate the question of whether third-party above rail operators have countervailing power from the question of whether a substitute for the above-rail service currently exists. As coal cannot effectively be transported using non-rail transport in the relevant geographic market, then the below-rail network is a monopoly and above-rail train operators will be largely powerless to prevent Aurizon Network from exploiting that market

power. Moreover, the prospect of a rival rail network being developed does not offer an alternative source of negotiating strength for users of Aurizon Network's infrastructure.

65 In arguing that access regulation is not necessary to obtain access on reasonable terms, Aurizon Network presents the example of airport regulation in Australia where a light-handed regulatory regime has operated, in part, because the countervailing power of corporate entities in that market has provided an effective constraint on the prices and returns achieved by airports.[9]

66 It is worth examining the nature of the countervailing power that the Productivity Commission found operated when it reviewed whether airports had, and exploited, market power.[10] In short, the Productivity Commission found that some airlines had countervailing power because they were credibly able to leave an airport or to change the routes that they used. For example, it found that:

- Virgin Blue in Darwin had cancelled around a third of its flights, leaving the airport heavily reliant on Qantas.
- In relation to Canberra, around one third of flights serving the airport had been withdrawn since 2002, the majority of which originated from Sydney, from where alternative forms of transport were particularly competitive.
- Low cost airlines generally have higher countervailing power because they possess mobile assets which can be redeployed to more profitable routes at very short notice or withdrawn entirely.

67 In principle, in relation to the CQCN, third party rail haulers could redeploy assets to other networks, although my understanding is that there would be significant switching costs associated in redeploying assets because of differences in the gauges used across different rail networks. Specifically, the third party rail haulers will be unable to redeploy trains that utilised the narrow gauge below-rail network in the CQCN to standard gauge networks in other markets in Australia. Moreover, that threat – if followed through – simply has the effect of entrenching Aurizon Network's position in the above-rail market and could not be considered to be evidence of the existence of meaningful countervailing power in the market.

68 Importantly, miners – unlike third party rail haulage companies – do not have the ability to redeploy their assets and are at considerable risk of stranding.

69 The situation on the CQCN, therefore, is starkly different to that operating in the airport market and presented by Aurizon Network as evidence that regulatory intervention is not necessary to obtain access on reasonable terms.

70 As a result, Aurizon Network's call for the sort of light-handed regulation that has been applied in other industries should be rejected. Light-handed regulation (including reliance on commercial negotiation) might be relied upon to set rail access prices where the owner of the

[9] Aurizon Network submission, p.32.
[10] Productivity Commission 2011, *Economic Regulation of Airport Services*, Inquiry Report no. 57, Canberra.

below-rail network is subject to effective competitive pressure, either in the form of existing assets also competing at the below-rail level, or in the form of potential assets that other firms might credibly create within a meaningful timeframe. But where effective competition does not and cannot be expected to exist, a more detailed regulatory regime is likely to be required.

4.1 Summary of response to question 3

71 Users of Aurizon Network's below-rail network lack the countervailing buyer power that Aurizon Network claims supports the use of light-handed regulatory regimes that are currently used to regulate natural monopoly infrastructure operators in other industries. Consequently, a more detailed regulatory regime is likely to be required.

5 Q4: The likely prices experienced by above-rail providers and other access seekers if the CQCN was not subject to declaration and the associated impact of such prices on dependent markets

72 In order to form a view of where prices will end up, it is helpful to revisit the nature of competition in the relevant market. As I mentioned in my response to question 2, as Aurizon Network's below-rail assets are not subject to effective competitive pressure, either in the form of other facilities that could be used to transport coal from mine to port or from the prospect that new, alternative infrastructures might be created, I concluded that competition in the below-rail market is not effective. As a result, I would expect prices for the rail haulage service ultimately paid by miners to increase to monopoly levels absent declaration, potentially affecting the viability of some miners using the CQCN.

73 This finding is reinforced by the following observed market evidence:

- First, the lack of commercially viable non-rail coal haulage options.
- Second, Aurizon Network is vertically integrated meaning that the downstream problem will usually be more serious because of the potential for the infrastructure owner to distort competition in related markets, which in this case is the rail haulage market. Accordingly, prices are more likely to depart from competitive outcomes and there will be a stronger case for intervention to ensure that the rail operator does not favour their own train operating service.

74 It is also possible that higher below-rail access prices could affect competition in markets other than rail haulage markets.

75 The coal market, for example, is one where the price is driven by prevailing supply and demand conditions. As discussed in section 3 of our first report to the QCA estimating demand for the CQCN, all coal mines that compete on the export market are ranked in terms of cost efficiency in order to generate an industry supply curve. The prevailing price in the relevant market is determined by the intersection of demand with the supply curve, where effectively the marginal

cost of production of the marginal coal mine determines the prevailing price; it is effectively a fixed global price – miners in the CQCN are price takers.

76 If the coal mines in the CQCN either currently represent marginal suppliers on the supply curve or would likely do so in the future, then an increase in rail haulage charges which affects the marginal cost of those mines could lead to an increase in the price of export coal. This effect will depend on the shape of the price setting segment of the supply curve. If the supply curve is rising sharply at the intersection with demand, this will imply a larger impact of any increase in marginal cost than if the supply curve is relatively flat at the intersection with demand.

5.1 Summary of response to question 4

77 I would expect prices for the rail haulage service ultimately paid by miners to rise to monopoly levels and affect the viability of those miners using the CQCN who are less able to bear fixed costs, leading to the inefficient displacement of CQCN production.

6 Q5: The impact on productive, allocative and dynamic efficiency if the CQCN was not subject to declaration

78 The concept of economic efficiency generally refers to the ability of society to get the most that it can from its scarce resources. The concept of economic efficiency encompasses the following three dimensions.[11]

- First, productive efficiency requires that goods and services be produced at the lowest possible cost.
- Second, allocative efficiency requires that available resources be used to produce the goods and services that consumers value the most. In general, this will be achieved when the price of the good or service is equal to the marginal cost.
- Third, dynamic efficiency requires "industries to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities".[12]

79 I first discuss the ways that productive efficiency will be affected by declaration, before addressing allocative efficiency. Allocative efficiency is most likely to be affected by a decision to declare the CQCN (or not), at least in the short term. I then discuss the way that dynamic efficiency is also likely to be affected by declaration.

6.1 Effect on productive efficiency

80 Productive efficiency is mainly relevant to the question of whether effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics,

[11] Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66, Canberra, p. 77.
[12] Commonwealth of Australia, 1993 *National Competition Policy*. A Review chaired by Professor Hilmer ("the Hilmer Report"), p 4

and which cannot (and should not) be duplicated economically. It is therefore most relevant to the "natural monopoly" limb of the test for declaration.

81 Productive efficiency could also be enhanced by declaration if declaration avoids excessive below-rail access prices that displace efficient CQCN production. That is, even if the global price for coal remains unchanged (that is, even if competition in the global coal market is unaffected), declaration could help avoid inefficient displacement of CQCN production where efficient but viable mines using the CQCN are forced out of the market and their production replaced by less efficient mines operating outside the CQCN.

6.2 Effect on allocative efficiency

82 There are two ways that declaration – or the lack of declaration – will affect allocative efficiency.

83 First, as a result of the "monopoly concern" that I discussed in response to question 1. That is, the owner of the facility is able to charge higher prices and derive monopoly profits at the expense of miners and economic efficiency. Aurizon Network has claimed that mines vary greatly in their ability to bear fixed costs associated with the provision of rail lines or network, which I explained in response to question 1 suggests to me that demand for the services provided over Aurizon Network's below-rail network is likely to be elastic. As a result, an increase in the price of the below-rail service in the absence of declaration may lead to a reduction in output that access regulation is designed to avoid.

84 In its review of the National Access Regime, the Productivity Commission argued that an infrastructure service provider is likely to have a greater incentive to deny access or charge monopoly prices and reduce output where the service provider has an upward sloping average cost curve, for example where the facility is approaching capacity constraints.[13] Its reasoning was that as a facility reaches capacity, the marginal cost of supplying additional services is likely to increase, meaning that the marginal costs will exceed average costs, and average costs will increase with output over the relevant production range.

85 In that case, the incentive to deny access or charge monopoly prices and reduce output is heightened in order to enable the monopolist to reduce its average costs. The Productivity Commission argued that although the average cost benchmark is likely to be higher for a facility with little surplus capacity, reduced allocative efficiency can still be expected because the service provider will still have an incentive to set prices in excess of its marginal cost of supply.

86 Second, allocative efficiency will be affected as a result of the "downstream concern", which relates to the effect of competition in the above-rail or rail haulage market.

87 I note here that Aurizon Network has acknowledged the allocative efficiency benefits associated with declaration. On page 13 of its submission, for example, Aurizon Network states that:

[13] Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66, Canberra, p. 77, p.79.

> *"Aurizon Network acknowledges that third party entry into the rail haulage market in central Queensland has coincided with substantial productivity improvements in that market."*

88 Aurizon Network argues that those improvements have also come with significant costs of regulation and associated efficiency loss from coordinating multiple users of rail infrastructure and the significant transaction costs associated with vertical unbundling.

89 At one level, it is not surprising that costs have been incurred by Aurizon. But these types of costs are typically considered to be worth incurring in order to secure the dynamic benefits of rivalry. In this case, they are required in order to deliver benefits, including lower prices, to miners using the rail haulage service. The relevant question is whether they have exceeded the benefits that has been provided by declaring the service.

90 Aurizon Network claims that the industrial organisation literature supports its claim that the costs of regulation are significant. Specifically, it argues that the literature has generally concluded that the optimally efficient market structure for railways is vertical integration because of the transaction costs associated with separation and the coordination failure of the below and above rail operations from vertical unbundling. Aurizon Network claim that this is supported by a study by Mizutani and Uranishi.

91 It is not clear to me that the analysis by Mizutani and Uranishi does, in fact, support Aurizon Network's argument. Instead, the authors find that:

> *"…there exists no definitive theoretical study of vertical separation in the railway industry. If we review existing literature from a theoretical point of view, we must say it is not clear whether a separation policy (i.e. vertical separation or vertical integration) is desirable. As for empirical studies, there are many, but their results are not consistent. Some studies such as Shires et al. and Kim and Kim (2001) show that vertical separation is relatively more efficient than vertical integration." (p.35)*

92 Indeed, Mizutani and Uranishi's main finding appears to be that vertical separation is *more cost effective* than vertical integration when train density is low.

93 Whether the CQCN is a low or high density network is ultimately an empirical question. The key point is that Aurizon Network's assertion that the industrial organisation literature for railways has generally concluded that the optimally efficient market structure for railways is vertical integration cannot be supported.

94 Ultimately, however, the question of whether train density is high or low is not the primary question for the QCA. As I have stated in response to question 3, the key question is whether there are realistic prospects of competition emerging in the below rail market. As users of the below-rail network have no viable non-rail alternatives to transport coal from their mines to port then the outcome of any commercial negotiation is likely to lead to a price that reflects Aurizon Network's monopoly position in the provision of below-rail services.

95 That question, that is whether there are realistic prospects of competition emerging in the below rail market, is far more relevant to the QCA's assessment than the question of whether the train density on the CQCN is high or low.

6.3 Effect on dynamic efficiency

96 Dynamic efficiency can be harmed either through inappropriate regulation or through the absence of regulation.

6.3.1 Harming dynamic efficiency through inappropriate regulation

97 Aurizon Network refers to the risks of harming dynamic efficiency by declaring the CQCN. Specifically, it claims that dynamic inefficiency is likely to take the form of the removal of incentives for Aurizon Network to invest in economically-efficient practices, projects or technology.[14]

98 I agree with Aurizon Network that declaration can potentially harm dynamic efficiency. However, the regulatory framework applied by the QCA is capable of providing meaningful protection to access owners that declaration will protect dynamic efficiency. These protections are found in the ability – and demonstrated willingness – of the QCA to set prices for access as well as declaring services.

99 In other words, once a decision has been made by the QCA that competition cannot be relied upon to generate access prices to the below-rail network that are consistent with effective competition and that declaration can in this case overcome both the monopoly and downstream problems, then dynamic efficiency can be protected by setting a regulated price that strikes the right balance between static and dynamic efficiency.

100 The regulatory regime in this case – by ensuring that regulated prices will be set by the QCA rather than deferred to another body for review therefore creating uncertainty in the market for potentially a long period of time – is well placed to arrive at a price that strikes that balance. Provided that prices are set at a level that enables Aurizon Network to recover all of the relevant costs and that promotes worthwhile new investments in the rail network (for example, by allowing for capital expenditures through that regulated price-setting process), then there is no reason why declaration should harm dynamic efficiency.

6.3.2 Harming dynamic efficiency through the absence of regulation

101 Dynamic efficiency can also be harmed if the QCA declines to declare the CQCN. In that case, dynamic efficiency will be compromised if coal miners have made significant (and sunk) investments. In this situation, a negotiation with a below-rail access provider with substantial market power is likely to lead to an outcome that harms dynamic incentives as the below-rail operator is in a strong position to expropriate any investments made by that miner.

[14] Aurizon Network submission, p.16.

102 Current as well as prospective miners will be much more cautious when considering productivity-enhancing investments if there is a risk that Aurizon Network will expropriate the benefits of those investments by raising the price of access to the below-rail network.

6.4 Summary of response to question 5

103 Declaration will impose costs on the below-rail infrastructure that is being regulated. But those costs will usually be worth incurring in order to achieve the efficiency benefits associated with promoting competition as well to improve allocative efficiency both in the below-rail market and in other markets that rely on access to Aurizon Network's below-rail network.

7 Q6: If the Newlands and/or the Moura systems were not subject to declaration, the likelihood that any lost production, investment and employment from that/those systems would be replaced by new or increased production, investment and employment (from another CQCN system or otherwise).

104 My response to this question depends on the nature of competition in the export coal market. My understanding is that this market is a global market meaning that the price of export coal is ultimately determined by the intersection of demand and supply (which, in turn is made up of the costs of all coal mines for that grade of coal).

105 All mines – that is, those currently operating as well as prospective new developments – would be positioned on the global cost curve in the manner described in paragraph 75 of this report. If the global price is such that firms can cover their costs, including profit, then they would produce coal and supply it to the global market. If not, then then they would either enter into "care and maintenance" or not enter into production at all.

106 This means that if the Newlands and/or Moura systems were not subject to declaration, I would expect the following to happen in terms of new or increased production, investment and employment.

107 If the coal mines that use the Newlands or Moura systems are infra-marginal miners on the supply curve – that is, if they are relatively low cost miners positioned on the lower end of the supply curve – then I would expect their costs to increase and perhaps a re-ordering of the cost curve to occur, but I would not necessarily expect any change in the price of coal, or for there to be any new or increased production, investment and employment. This is because a change or re-ordering of infra-marginal suppliers will not affect the intersection of the demand curve with the marginal supplier in the downstream export coal market.

108 If the coal mines that use the Newlands or Moura systems are marginal suppliers on the supply curve, and if those systems were not subject to declaration, then there may be some effect on the price of export coal and some effect on new or increased production, investment and

employment. In this case, the lack of declaration may lead to an increase in the marginal costs of coal mines that use the Moura or Newlands systems and may lead them to cease production (in the short or long term depending on how the global price moved over time).

109 But if the coal mines that used those networks did cease production, it is not clear what the implications would be for new or increased production, investment and employment. A detailed assessment of the likely demand and supply conditions for coal is needed in order to determine what those effects will actually be.

110 If the mines on those systems were currently producing or were expected to be entering production in the short to medium term, then that lost production would need to be replaced. That lost production could either be replaced by:

- A marginal supplier who will enter the market – and who could be located along the CQCN or anywhere else in the world;
- By existing intra-marginal miners increasing their production. These intra-marginal miners could also be located along the CQCN or elsewhere.

7.1 Summary of response to question 6

111 If the coal mines that used the Moura and Newlands networks did cease production, it is not clear what the implications would be for new or increased production, investment and employment. That lost production could be replaced by other mines operating in the CQCN but that could not be assured. A detailed assessment of the likely demand and supply conditions for coal is needed in order to determine what those effects will be in practice.

8 Compliance with expert guidelines

112 I have been provided with a copy of and have read Practice Note CM7: Expert witnesses in proceedings in the Federal Court of Australia issued on 4 June 2013 (**"Expert Guidelines"**). I confirm that I have read, understood and agree to be bound by the Expert Guidelines.

113 I confirm that I have made all the inquiries that I believe are desirable and appropriate and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from this report.

George Siolis
Partner, RBB Economics
16 July 2018

Annexes

A CVs

CV - George Siolis

George joined RBB Economics in July 2009 as a Partner in the Melbourne office. He has worked as a micro-economist for 25 years and has advised clients in Australia, Asia and Europe, including the European Commission on a wide range of policy issues. He has specialised in the application of economics to competition and regulatory issues across a range of industries including coastal shipping, agriculture, manufacturing, telecommunications, and financial services.

George has advised on many of the most contentious mergers before the ACCC since RBB Economics was established in Australia in 2009 and has presented expert evidence before the Australian Competition Tribunal. He is listed in the GCR's *Who's Who Legal 2017 edition of Competition Lawyers and Economists* and is also a member of the Competition and Consumer Committee (Business Law Section) of the Law Council of Australia.

Prior to joining RBB, George worked for Telstra where he helped determine prices both in regulated wholesale markets as well as in competitive retail markets. George was also an economic consultant in the UK for eight years where he developed and led the communications practice at Europe Economics. George began his career at the Productivity Commission (formerly the Industry Commission) in their Canberra and Melbourne offices and was awarded the Commission's first Overseas Development Award in 1995.

His project experience acting as an expert on economic issues covers the following:

Competition expertise while at RBB Economics

George has provided expert advice to a number of clients where the ACCC had raised significant competitive concerns on proposed mergers including:

- Advised Sea Swift and Toll Marine Logistics on the proposed acquisition by Sea Swift of the Northern Territory and far north Queensland marine freight business of Toll Marine Logistics Australia (a division of Toll Holdings Limited, whose ultimate owner is Japan Post). The proposed acquisition was initially opposed by the ACCC, but Sea Swift successfully sought Authorisation from the Australian Competition Tribunal on the basis that the proposed acquisition would result in such a benefit to the public that it should be allowed to occur. George advised the parties throughout the process and presented expert evidence before the Tribunal during the Authorisation process.

- Advised Shell during their proposed acquisition of BG in Australia.

- Advised Heinz on the likely competitive effects in the wet and dry infant food markets of its proposed acquisition of Rafferty's Garden in Australia.

- Advised Asahi (Schweppes) on their acquisition of Mountain H2O in Australia. The merger combined the major supplier of private label (and some branded) water to major supermarkets with a large supplier of branded bottle water.

- Advised Thomson Reuters on their proposed acquisition of E&Y's tax compliance software business.

- Advised Swift on their proposed acquisition of Rockdale.

- Advised Sleepyhead on their proposed acquisition of Dunlop Foams (a division of Pacific Brands).

- Advised Cargill on their proposed acquisition of the fats and oil businesses of Goodman Fielder.

- Advised National Australia Bank's proposed acquisition of AXA.

- Advised Link on their proposed acquisition of Newreg.

- Advised Donohoe Ice and Bells Pure Ice on their proposal to merge their respective packaged ice manufacturing and distribution and cold storage services businesses.

- Advised a leading online employment website operator in Asia on a proposed merger.

George has also advised parties on a wide range of other competition and regulatory issues while with RBB Economics.

- Prepared two expert reports for – and appeared at an Arbitration hearing on behalf of – Brookfield Rail on the economic considerations around pricing for access to rail services in Western Australia. The reports examined the economic efficiency implications of a regulated price for access to a natural monopoly facility and reviewed the methodology developed by a major freight customer to determine a cost-oriented price for access to Brookfield's rail network.

- Wrote an expert report on behalf of the New Zealand Commerce Commission in its proceedings against Hamilton real estate agencies, which was submitted to the High Court in Auckland. The Commerce Commission alleges that the real estate agencies breached the Commerce Act by entering into anti-competitive agreements in response to Trade Me changing its property listing fee.

- Advised local fibre companies in New Zealand on regulatory issues concerning fibre unbundling.

- Advised the ACCC as part of its inquiry into whether to declare domestic mobile roaming. RBB's work involved reviewing a report and model by Frontier Economics that sought to quantify the consumer benefits of domestic roaming.

- Provided expert witness reports on behalf of the Commonwealth of Australia (Department of Communications) on two litigation matters arising out of commercial disputes regarding broadband provision to rural and regional areas in Australia.

- Provided expert advice to wholesale fruit and vegetable traders in Melbourne in a dispute with the Melbourne Market Authority over a commercial dispute. The case settled before George could present his expert evidence in the Supreme Court of Victoria.

- Advised Genesee & Wyoming (Australia) during an investigation by the Essential Services Commission of South Australia (ESCOSA) on whether the prices charged by Genesee & Wyoming for access to the Tarcoola to Darwin railway line have been excessive.

- Provided advice to the provider of tug boat services at a port in northern Australia on the likely effects of the decision by the port operator to license a second tug boat operator to provide services at that port.

- Advised Asciano in Australia on the appropriate methodology that the regulator should use to set access prices for rail services provided by Patrick at Port Botany.

- Advised Viterra on the design of an auction to allocate capacity to third party grain exporters to Viterra's ports.

- Advised Tooltechnic during their Application for Authorisation to engage in Resale Price Maintenance (RPM). This was the first Authorisation for RPM ever granted in Australia.

- Advised Realestate.com.au during the ACCC's review of the proposed Authorisation sought by Property Media Group Pty Ltd (PMG) to collectively bargain and boycott suppliers of online and print real estate advertising. The ACCC rejected the Application (which was subsequently withdrawn) because it considered that while realestate.com.au and domain.com.au have some market power, there is evidence of competition both between each other and from other small and mid-tier players.

- Provided economic advice to SunRice and an expert report to the Independent Consumer and Competition Commission in Papua New Guinea (PNG) on whether SunRice had and was exploiting its market power in the domestic rice market in PNG.

- Advised Telstra on the appropriate approach to determining service lives of new fixed network assets and remaining service lives for Telstra's existing fixed network assets to use in such a building block pricing framework.

- Advised the jet fuel suppliers at Sydney Airport (JUHI) during the Application for declaration of their infrastructure services made by the Board of Airline Representatives of Australia Inc (BARA). The National Competition Council declined to provide access to the jet fuel supply infrastructure to BARA (and found the evidence of RBB to be "compelling").

Regulatory experience at Telstra

Prior to joining RBB Economics George was a Pricing Specialist at Telstra and then led the Regulatory Accounting and Cost Modelling team at Telstra. His role there included:

- Working with the marketing and product teams at Telstra to set retail prices for products sold by the Consumer teams at Telstra with the aim of maximising the average revenue per user (ARPU) while protecting market share. This involved developing financial models showing the extent to which consumers would take-up the new products (measuring the penetration rate), estimating how many consumers would substitute other Telstra products for the new product (the rate of cannibalisation), determining how many people would abandon the product over time or move to a competitor's offering (the rate of churn), and estimating the price response of competitors which could then affect Telstra's pricing and market share estimates (the competitor's response).

- Producing (audited) regulatory accounts to the ACCC to ensure Telstra's compliance with its Accounting Separation obligations.

- Producing cost models (including the joint network cost model (JNC model) to allocate the costs of Telstra's (shared) networks over all of its products and services.

- Providing advice to the Chief Financial Officer on all matters concerning Regulatory Finance matters.

The role of the team was then expanded to report on the profitability of Telstra's products at a more detailed level in order to guide pricing and investment decisions.

Other regulatory, and cost modelling experience

Between 1997 and 2004, George worked as an economic consultant in the UK for National Economic Research Associates (NERA) and Europe Economics (where he developed and led the telecommunications team). His experience during this time included the following:

Regulatory experience

- Directed a study for DG Competition at the European Commission aimed at exploring the reasons for differences in prices for unbundled local loops across EU Member States and at identifying the best practice with regard to estimating costs and setting prices for these services. The study looked at the appropriateness of various costing methodologies, particularly the use of long run incremental cost (LRIC), and at how different methodologies can meet the Commission's policy objectives.

- Provided expert testimony on behalf of the Director of ODTR (the Irish regulator) in a High Court Judicial Review brought by Eircom regarding the price of unbundled local loops in Ireland.

- Prepared a response for the United Kingdom Competitive Telecommunications Association (UKCTA) to Oftel's Consultation Document on Financial Reporting Obligations for Operators with Significant Market Power. The response looked at

measures that could limit the market power of vertically integrated operators and for ways to strengthen regulations aimed at avoiding anti-competitive behaviour.

- Project director in a study for the Jersey Competition Regulatory Authority aimed at assessing Jersey Telecom's efficiency in comparison with other European and US operators, using industry-standard summary ratios and econometric techniques (SFA and DEA).

- Directed a study for DG Enterprise, European Commission to develop a set of analytical tools to help competition authorities take account of the innovation when conducting their investigations into the effects of a merger or anti-competitive behaviour in dynamic industries.

- Conducted a feasibility study and cost benefit analysis of the introduction of mobile number portability in Hong Kong for OFTA. The role included a major presentation to the telecommunications industry in Hong Kong outlining the methodology used to estimate the benefits of number portability and presenting the results of the study to the industry in Hong Kong.

- Advised the Independent Television Commission (ITC) on the economic effects of bundling practices of the cable television operators. This work led to a part time secondment for six months to the Economic Regulation Division of the ITC reporting to the Head of Economic Regulation to advice on mergers, competition policy and other public policy issues.

- Advised the Office of Electricity Regulation in the UK on the separation of distribution and supply businesses.

- Conducted a comparative review of economic regulation in EU Member States in order to develop recommendations for the Finnish Communications Regulator, FICORA to improve its effectiveness as a regulator.

- Prepared a response for Kingston Communications in response to an efficiency study conducted on the company by Oftel.

- For the Office of Utility Regulation in Guernsey, reviewed proposed charges submitted by the incumbent operator, Cable & Wireless Guernsey, and assessed the extent that these met the requirements set out by the Office of Utility Regulation in the legislation.

- Project manager of a study for the National Competition Council, on Overseas Experience in reform of postal services. The study looked at the experience of the UK, Sweden, Finland, Canada, New Zealand and the Netherlands and was used by the ACCC to inform their wide ranging review of Australia Post.

- Lead consultant for an economic impact study for a consortium in Singapore bidding for a fixed telecommunications licence in Singapore. The economic impact study measured the effect on Singapore's GDP of awarding the licence to the bidder.

Cost modelling expertise

- Led a (long-term) project for IT-og Telestyrelsen (the Danish regulator) on the development of bottom up and top-down models in Denmark in order to produce interconnection charges for PSTN services and unbundled local loops. The study required the preparation of criteria and minimum requirements for both models, advice on the preparation of the models, a reconciliation of the bottom-up model with the top down model built by Tele Danmark, and the development of a hybrid model to set prices for 2003.

- Directed a detailed costing model for the fixed network in Spain (for the Spanish Telecom Regulator, CMT), in order to calculate the cost of interconnection with the incumbent's network (both circuit-switched and IP networks), and providing direct and indirect access to customers and other operators. Retained by CMT to update the cost model and compare the outputs with those obtained by the incumbent operator, Telefonica.

- Directed a study for AGCOM (the Italian regulator) to verify the costs calculated by Telecom Italia (TI) in order to meet their universal service obligations (USO). The study assessed the appropriateness of the methodology used by TI, the accuracy of the algorithms in their model, and the reasonableness and reliability of the assumptions made by TI.

- Managed a project on the development of a bottom-up model to estimate the cost of leased lines in the UK for Oftel in the UK. The models calculated the cost of leased lines under different definitions of the cost increment including incremental costs, fully allocated costs and stand-alone costs. The study also included a paper outlining the advantages and disadvantages of different costing methodologies, a number of presentations to the industry, and the reconciliation of the results of the bottom-up model with the results from BT's top-down model.

- Lead consultant on a project for Singapore Telecom, based in Singapore, to estimate, using top-down and bottom-up methodologies, the long-run incremental cost of different interconnection services. Costing models were developed for both the access and core network and were presented to the telecoms regulator TAS.

- Conducted a training session to the Cost Accounting experts at the Romanian regulator, ANRC and provided advice on how different costing methodologies can be used to determine interconnection charges and to assist the ANRC respond to responses to consultations on related issues. Retained by ANRC to develop a detailed bottom-up, long run incremental cost model in order to estimate the costs of RomTelecom's network.

- For the ACCC, advised on the project team to build a bottom up model to estimate interconnection charges in Australia (until May 1998). The project involved the development of long run incremental cost model to estimate the costs of Telstra's network.

- Managed a project for DG XIII of the European Commission to build an adaptable "bottom-up", forward-looking long-run incremental cost model for the purpose of

calculating PSTN charges. The model has since been used in a number of member states including France and Austria.

- Managed a project for DG XIII of the European Commission to provide a clear basis for the assessment and allocation of costs for number portability and call-by-call carrier selection/ pre-selection.

- For ODTR, conducted a high level review of the LRIC methodology developed by Eircom and recommended changes to their cost accounting system to ensure compliance with ODTR requirements.

QUALIFICATIONS

1991 **BEc (Hons) Economics and Political Science,** Monash University

2014 **Master of Laws (Juris Doctor)**, Monash University

B Engagement Letter

HERBERT SMITH FREEHILLS

Attention: Mr George Siolis
RBB Economics
Level 51
101 Collins Street
Melbourne VIC 3000
George.Siolis@rbbecon.com

2 July 2018
Matter 82654805
By Email

Dear Mr Siolis

Confidential and Privileged

Central Queensland Coal Network – 2020 Declaration Review – Submissions on Initial Submissions

Your engagement as an independent expert

1 Introduction

We act for the Queensland Resources Council (**QRC**), a not-for-profit peak industry association representing the commercial developers of Queensland's minerals and energy resources.

By acting for the QRC, HSF indirectly act for a selection of its members, being Anglo American, BMA, Fitzroy Australia Resources, Glencore, Idemitsu, Sojitz, QCoal, Peabody, Whitehaven Coal, New Hope, Caledon, Jellinbah, Rio Tinto, Wesfarmers Curragh and Yancoal.

This letter is to confirm RBB Economics' (**You/Your**) retainer to act as an independent expert in relation to the consideration of economic matters raised in the initial submissions made in response to the assessment of the declaration of the Central Queensland Coal Network (**CQCN**), owned by Aurizon Network Pty Ltd (**Aurizon Network**), and to set out the terms of your retainer.

QRC is responsible for payment of your fees, although your accounts are to be addressed to our office as referred to below.

2 Background

The CQCN, owned by Aurizon Network, is a 'declared service' within the meaning of the Queensland Competition Authority Act 1997 (Qld) (**QCA Act**). Specifically, the 'declared service' as defined in s 250(1)(a) of the QCA Act is the use of a coal system for providing transportation by rail, being a service owned by Aurizon Network.

This declaration expires on 8 September 2020.

The Queensland Competition Authority (**QCA**) is reviewing whether the CQCN should continue to be a 'declared service' (in whole or part) following the expiry of the existing declaration in 2020 (**Declaration Review**).

Initial submissions by Aurizon Network (**Initial AN Submission**) and other interested parties (including the QRC) were made to the QCA. The QCA has now invited responses to these submissions. As part of this, the QCA has also published an issues paper on specific issues arising from the initial submissions (**Further Issues Paper**).

Doc 72582584

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3 Scope of your assignment

We would like you to prepare an independent expert report in which you address economic matters relevant to the regulation of the CQCN, including those economic issues raised in the Initial AN Submission. This report may ultimately form part of (or be annexed to) a submission made in response to the initial submissions and the Further Issues Paper or be relied upon in litigation arising out of the Declaration Review.

In particular, we request that in preparing your report, you address the following:

- the economic rationale for access regulation, particularly in relation to the regulation of below-rail infrastructure such as the CQCN;
- the constraints that would operate on and the incentives faced by Aurizon Network if the CQCN was not subject to declaration;
- the countervailing power of above-rail providers and other access seekers if the CQCN was not subject to declaration;
- the likely prices experienced by above-rail providers and other access seekers if the CQCN was not subject to declaration and the associated impact of such prices on dependent markets;
- the impact on productive, allocative and dynamic efficiency if the CQCN was not subject to declaration; and
- if the Newlands and/or the Moura systems were not subject to declaration, the likelihood that any lost production, investment and employment from that/those systems would be replaced by new or increased production, investment and employment (from another CQCN system or otherwise).

For your assistance, we also include a short guide to preparation of an expert report as Attachment 1 to this letter.

From time to time you may be required to respond to additional matters if and as those matters arise.

4 Confidentiality

Your consultancy report and any drafts prepared in accordance with your retainer are confidential and are not to be copied or used for any purpose unrelated to the purpose for which you are retained without the permission of QRC.

Materials supplied to you by the QRC or Herbert Smith Freehills as their legal advisor are confidential and are not to be copied or used for any purpose unrelated to your retainer without the permission of QRC.

Your report and any drafts prepared by you should also have the following words inserted on the cover page:

> *This document is protected by legal professional privilege. To ensure privilege is not waived please keep this document confidential and in a safe and secure place. This document should not be distributed, nor any reference to it made, to any person or organisation not directly involved in making decisions on the subject matter of this document. If this document is requested by a government officer, Herbert Smith Freehills should be contacted immediately to ensure that privilege is claimed over the document and it should not be shown to, nor the contents discussed with, the government officer.*

You and any other persons who will be assisting you may be requested to execute a confidentiality undertaking. You may be required to return all documents, copies and workings at the conclusion or termination of your retainer.

5 Conflicts of interest

As an independent expert, it is important that you are free from any possible conflict of interest in the provision of your opinions and report. You should ensure that you have no connection with Aurizon Network, QCA and QRC, which would preclude you from providing your opinion in an objective and independent manner.

Please let us know if you have had any dealings with any of the parties.

In addition, if during the course of your retainer period you become aware of an actual or potential conflict of interest, please inform us immediately.

6 Fee estimate

We would be grateful if you could please confirm details of your rates for this engagement.

Expenses such as taxis, flights, accommodation, parking, couriers, printing etc are to be billed at cost.

You may be asked to provide an estimate of fees. Should you become aware that your fee estimate is likely to alter in a material way, you must notify Herbert Smith Freehills immediately of the likely change and obtain approval for any material increase.

You should present your memoranda of fees by 8 June 2018. This will assist us to deliver an overall memorandum to QRC.

As mentioned above, it is Herbert Smith Freehills' client which is responsible for paying your fees.

7 Liability for fees

QRC will be responsible for the payment of your invoices. However, as Herbert Smith Freehills is engaging you on behalf of the QRC, please forward your invoices to Herbert Smith Freehills' office.

8 Communications

All communications, whether verbal or written, should be directed to our office, so that we can coordinate, manage and integrate work activities with legal requirements and ensure privilege is maintained as appropriate.

9 Your duties and responsibilities as an expert witness

Your role is that of an independent expert engaged to advise Herbert Smith Freehills on behalf of QRC on the technical matters the subject of this retainer.

Though you are retained by Herbert Smith Freehills on behalf of QRC, you are retained as an independent expert to assist Herbert Smith Freehills in providing legal advice to our client. Accordingly, you are expected to be objective, professional and to form an independent view as to the matters in respect of which your opinion is sought.

Your report must give details of your qualifications, and of the literature, documents and other material used in making the report.

All facts and assumptions on which your opinion is based should be clearly and fully stated. You should not omit to consider material facts which could detract from your concluded opinion.

You should give reasons for each opinion. Where appropriate you should also state the methodology you have used.

Until your report is in final form it should not be signed. You should, however, be aware that that unsigned draft reports may need to be disclosed to other parties.

If, at any stage, you change your view on a particular matter, you should inform us in writing of the change of view without delay.

If, despite the information provided to you and the assumptions you have been requested to make, you consider that your opinion is not properly researched because of insufficient data, or for any other reason, you should state clearly that your opinion is a provisional one. Similarly, if you believe that your opinion is incomplete or inaccurate without some qualification, that qualification must be stated in your report.

You should make it clear if a particular question or issue falls outside your area of expertise.

10 Acceptance of terms

If the above terms are accepted, please sign and date a copy of this letter and send a copy to our offices by email.

We look forward to working with you.

Yours faithfully

Matthew Bull
Partner
Herbert Smith Freehills

+61 3 9288 1582
+61 448 259 556
matthew.bull@hsf.com

Richard Robinson
Senior Associate
Herbert Smith Freehills

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+61 447 168 141
richard.robinson@hsf.com

date 2/7/2018

sign here ►

name of expert GEORGE SIOLIS

HERBERT SMITH FREEHILLS

Attachment 1

Preparation of your expert report

1 Introduction

Your introduction should contain the following information:

(a) A summary of your qualifications and experience (or reference to the appropriate paragraph in a statement you have previously filed in the proceedings).

(b) The scope of your assignment, including:

(1) the questions you have been asked;

(2) the assumptions (if any) you have been asked to make; and

(3) reference to the appendices or attachments in which these are set out.

(c) A list of people who have assisted you in the preparation of your report, including their qualifications and the roles they played.

(d) Reference to the appendices or attachments setting out the lists of documents you have relied on, and been supplied with.

(e) Each paragraph of the report should be numbered, the pages should be numbered and the report should be in double spacing.

2 Summary of opinions

In the case of reports where a number of opinions have been expressed, a summary of your opinions should appear between the introduction and body of the report.

3 Appendices or attachments

As a minimum, your report must have the following appendices or attachments:

(a) Your curriculum vitae (if this is the first report you have filed in these proceedings).

(b) The question(s) supplied by Herbert Smith Freehills which you answered in your report.

(c) The assumptions (if any) you were asked to make for the purposes of preparing your report.

(d) A list of documents you have relied on for the purposes of preparing your report.

(e) A list of documents supplied to you by Herbert Smith Freehills.

4 Checking the Report

(a) **Paragraph numbering and cross referencing**

If you have made multiple drafts of your report it will be necessary to check the paragraph numbering remains sequential and that cross referencing is still accurate.

(b) **Footnotes**

Check footnotes are on the same page as the paragraphs to which they refer.

Check that every document referred to in a footnote is in the list of documents relied on in the appendices.

(c) **Documents relied on**

Check that every document referred to in the report is in the list of documents relied on in the appendices.

Prepare a copy of every document relied on in your report for sending to Herbert Smith Freehills when your report is filed. In the case of journal articles, internet printouts, media reports, statistics etc, copies of the entire document are required. In the case of text books or other large publications, a copy of the front cover, title page, page showing publication details including edition and year of publication, and entirety of any chapter containing material referred to are required.

(d) **Signing off on your Report**

When your report is fully completed you must ensure that the last page of the body of the report (ie before any appendices, exhibits or attachments) is signed and dated. There is no requirement for signature to be witnessed.