

Chapter 1 - Background

KEY ASPECTS

March 1998 – Queensland Government declares the services provided by QR's intrastate rail transport infrastructure for third-party access purposes.

June 1998 – Queensland Government extends declaration by removing the exemption relevant to access to coal lines.

January 1999 – QR voluntarily submits a Draft Undertaking in relation to certain services relating to the use of rail transport infrastructure that it owns to the QCA.

January 1999 – October 2000 – QCA undertakes an extensive process of consultation in relation to the Draft Undertaking.

Certainty – for the Undertaking to be approved it is necessary that it provide certainty for all parties to reduce the scope for disputes.

Balances interests – in assessing the Draft Undertaking, it is necessary for the QCA to balance the legitimate interests of QR with the interests of access seekers, knowing that in doing so it must take appropriate account of the public interest considerations relevant to development of competition in the above-rail market in Queensland.

December 2000 – QCA releases its Draft Decision on QR's Draft Undertaking.

March 2001 – May 2001 – QCA undertakes consultation in relation to the Draft Decision.

1.1 Introduction

Chapter 1 of the Draft Decision provides background to the QCA's consideration of QR's Draft Undertaking, including the assessment process and the role, content and approval of an undertaking under the QCA Act. Information on QR's organisational structure and the nature of its operations was also provided.

The QCA's Final Decision should be read in conjunction with the Draft Decision. This Final Decision expressly deals with the issues on which comments were received from stakeholders following the publication of the QCA's Draft Decision in December 2000. The QCA's views expressed in the Draft Decision on issues which are not further canvassed in this Final Decision remain the views of the QCA on those issues and are hereby incorporated by reference, and are to be treated as forming part of this Final Decision.

The format of Volume 2 follows that of the Draft Decision as far as possible, including the same chapter headings and sections within chapters, to reflect the fact that they are integrated documents and should be read as such. The discussion in the Draft Decision and this document under the heading 'QCA's Analysis' provides an explanatory guide to the QCA's position on each issue.

The QCA has adopted the following framework:

- changes to the Draft Decision have been made where an error has been identified;
- changes to the Draft Decision have been made where the QCA has accepted stakeholder' suggestions that it considers improve a position; and
- no change to the Draft Decision has been made where the QCA considers its position to be reasonable, notwithstanding stakeholder suggestions to the contrary.

1.2 Queensland Rail

QR is a government owned corporation under the *Government Owned Corporations Act 1993* having become so on 1 July 1995. Under this Act, the Treasurer and the Minister for Transport hold all the shares in QR on behalf of Queensland taxpayers. QR is required to pursue an unambiguous commercial charter, subject to complying with government directions. The Queensland Government decided in 1998 that QR would remain an integrated rail service provider.

QR announced an organisational restructure following the appointment of Mr Bob Scheuber as its new Chief Executive in December 2000.

The restructure merges QR's above-rail business groups into two divisions, passengers (incorporating Citytrain and Traveltrain) and freight (incorporating coal, minerals and QR's other freight operations). The train control function for the freight operations will be transferred to Network Access as part of the restructure.

QR's new structure is illustrated at the end of this chapter.

1.3 Declaration of QR's Infrastructure

The Queensland Government declared the services provided by QR's intrastate rail transport infrastructure for third-party access purposes in March 1998. The declaration was extended in June 1998 with the removal of the exemption on access to coal lines. The main effect of the declaration of a service is that it triggers a right for an access seeker to negotiate access with the

facility owner, backed by the compulsory dispute resolution provisions of the QCA Act if the parties are unable to agree on the terms of an access agreement. Division 7 of Part 5 of the QCA Act provides the framework within which access providers can prepare and the QCA can approve draft undertakings for declared and non-declared services.

1.4 QR's Draft Undertaking

On 23 January 1999, QR voluntarily submitted to the QCA a Draft Undertaking covering certain services relating to the use of the rail transport infrastructure it owns. A document entitled An Explanatory Guide accompanied that Draft Undertaking. It sought to clarify the intent of selected provisions in the Draft Undertaking. The QCA has interpreted the Explanatory Guide as if it formed a part of the Undertaking.

1.5 Assessment Process for Approval of Undertaking

The following parties have provided submissions in response to the QCA's Draft Decision:

- QR
- ARTC
- Curragh Coal Sales Co
- Dalrymple Bay Coal Terminal
- FreightCorp
- Gladstone City Council
- Jericho Shire Council
- Pacific Coal
- Ports Corporation of Queensland
- Queensland Government
- Queensland Treasury Corporation
- QMC
- Rail, Tram & Bus Union
- Stanwell

Stakeholder views

Process for finalisation of assessment of QR's Draft Undertaking

Curragh - supports the introduction of an Undertaking incorporating the amendments suggested in the Draft Decision and encourages a more rapid transition than suggested in the Draft Decision.

FreightCorp - if the QCA refuses to approve the Undertaking and QR does not indicate in its submission on the Draft Decision that it will amend it, the QCA should give QR an initial undertaking notice requesting QR prepare a draft access undertaking that complies with the QCA's Final Decision.

Pacific Coal - is concerned about the elapsed time to date and the absence of a firm forward timetable and clear accountability for the earliest achievement of an approved Undertaking. QR's Draft Undertaking has already taken more than 2 years for review. There is no timetable from either QR or the QCA for finalisation of an approved Undertaking. The absence of a publicly committed timetable is a major deficiency and Pacific Coal strongly recommends that this be addressed in the QCA's Final Decision.

QMC - it is essential the processes for finalising the QCA's Final Decision and an approved Undertaking be public and accountable. QMC strongly supports the public release of a Final Decision outlining the required amendments to the Draft Undertaking, with the rider that it must be subject to a strict timetable.

QMC's aim is to achieve an approved Undertaking within the shortest possible time frame. This should be the goal of all the parties given the work that has been done and which is contained in the Draft Decision. However, we are very concerned that unless the parties commit to a series of steps with clear time frames, and act in good faith towards achieving them, then the finalisation of the Undertaking will drift further.

We also believe the process must be actively and decisively managed by the QCA both in the lead up to and following the Final Decision. This is justifiable on two grounds. The first is that there is nothing in the Draft Decision to justify delaying the Final Decision beyond June. Indeed, QMC believes release of the Final Decision in May is feasible and should be the Authority's objective.

Second, the development and review of QR's voluntary undertaking over the last two and a half years was meant to take the place of the mandatory undertaking procedures in the QCA Act (ss133-135). If the consultative approach was allowed now to descend into a strict legalistic process following those mandatory procedures, this would constitute failure of the voluntary undertaking provisions of the act and reflect poorly on the credibility of all the parties.

Avoiding that outcome will require good faith on the part of the key participants in the review. It will also require the QCA to make it clear to the parties that, if necessary, it will implement the Final Decision in the form of a mandated undertaking within the minimum time period.

QMC recommends the QCA adopt a two-stage approach that seeks cooperation in the first instance, and failing that, imposes strict processes and deadlines to achieve a timely outcome. We ask that, prior to the Final Decision, the QCA:

- commit to releasing the Final Decision at the earliest possible time and no later than 30 June;
- confirm that it will issue an 'initial undertaking notice' to QR under s133 of the Act in conjunction with the Final Decision;
- request QR, as a demonstration of QR's cooperation and good faith, to:
 - commit to accepting the Final Decision and amending the Draft Undertaking accordingly;
 - begin immediately amending the Draft Undertaking in line with those elements of the Draft Decision which QR accepts;
 - agree to submit the Draft Undertaking, so modified, to the QCA as the 'initial Draft Undertaking' immediately upon receipt of the initial undertaking notice.

The above steps would initiate the mandatory undertaking process but effectively dispense with the initial Draft Undertaking step which, given the work of the last two and half years, the Final Decision would overcome the need for.

If QR declined to give the necessary commitments to enable this shortened process, QMC believes the QCA would be justified in moving to the second stage. This would involve the Authority releasing, as part of the Final Decision, a statement that:

- the QCA will strictly enforce the minimum time period for QR to provide an initial Draft Undertaking and, if necessary, a secondary Draft Undertaking, and will not use its discretion to extend either period;
- if there is a 'secondary undertaking notice' to QR, the QCA will include in the notice precise instructions for wording changes to the initial Draft Undertaking;
- if QR fails to provide an acceptable undertaking in response to a secondary undertaking notice, the Authority will prepare and approve an undertaking under s135 of the QCA Act;
- the QCA will start preparing an approved version of the undertaking straight away to assist it in evaluating QR's initial/secondary draft undertakings and, if need be, quickly prepare and approve an undertaking under s135.

In committing to the above steps in the Final Decision, the QCA would provide certainty by making it clear the decision will translate into an approved undertaking, and that it is only a matter of how soon. Also it would give QR up to six months to amend the Draft Undertaking in accordance with the Final Decision, which would be more than adequate time in our view to wrap up this process.

QMC strongly recommends the QCA seek to conclude the undertaking process by publicly committing to the above two-stage approach.

Queensland Government – the QCA has a number of legislative steps available to it that would enable the Authority to fully determine and establish an approved access undertaking. The Government supports the QCA in using these legislative processes to facilitate a speedy resolution to the current process. The Government is interested in bringing the current deliberations on the draft Access Undertaking to a close and would like the QCA to publish its Final Decision by end June 2001 and an approved Access Undertaking for QR's declared services as soon as possible thereafter, preferably by the end of 2001.

QCA's analysis

The QCA recognises stakeholder concerns about the urgency of having an approved Undertaking in place.

1.6 Undertaking - Role

Background

The role of an undertaking for a service is to set out details of the terms and conditions on which an owner undertakes to provide access to the service. These terms and conditions must necessarily deal with price and non-price matters. An undertaking approved by the QCA is intended to establish binding provisions to guide negotiation. It has the legal effect of constraining the QCA from making a determination in relation to an access dispute which is inconsistent with the undertaking (s119) and providing the owner with the capacity to create a safe harbour from provisions of the QCA Act which prohibit preferential self-dealing (ss104 & 105).

Stakeholder views

Lack of commercial or regulatory imperative

FreightCorp - encourages the QCA to view an access undertaking as representing the starting point for an access seeker and the least that an access seeker can expect. Equally as important is for the access undertaking to state what it is unreasonable for QR to seek, to limit transaction costs for access seekers.

Provisions of particular concern are those that allow the access provider to undermine, in practice, the rights to access and use of the infrastructure or to impose increased cost or risk on a train operator at the discretion of the access provider.

The best method for providing the base case may be regarded as Schedule E. (Alternatively, the Undertaking could state what must be included, and, as importantly, what must not be included, in a draft access agreement tabled by QR at the commencement of negotiation.)

We recommend that Schedule E should be developed before the standard set of terms for an access agreement and should state the base case for each access seeker and that which QR may not seek to include in any access agreement.

Interrelationship between the access undertaking and the QCA Act

FreightCorp - does not consider that s 119(1) of the QCA Act should be regarded as restrictive where an approved access undertaking does not provide for something. The Final Decision should state the QCA's view on the application of Section 119(1) of the QCA Act.

Interrelationship between Schedule E and the QCA Act

FreightCorp - considers that:

- Schedule E should be developed to represent the base case (Schedule E is not currently in a form, even if changed to reflect the QCA's findings to fulfil this role); and
- no access agreement may be inconsistent with Schedule E.

If Schedule E is not to be developed as suggested, the purpose of Schedule E should be stated more clearly. That purpose should be stated to act as a guide only as to what is reasonable and that it does not limit that which may be sought by an access seeker.

Currently, Schedule E provides QR with the means, in practice, to seek more than Schedule E provides for, in its favour, and to offer less than Schedule E provides for access seekers, in their favour. This has been confirmed in our negotiations with QR.

On these issues two key points are worth emphasising or re-emphasising:

- If an access seeker seeks a provision that is not contemplated in Schedule E, the QCA is not precluded from making a determination that allows the inclusion of that provision¹.

In this regard, there is an issue of clarification that is required. Chapter 8.1 states that:

"The Draft Undertaking provided that unless otherwise agreed between QR and a third party operator, an access agreement must be **consistent** with the principles contained in Schedule E."

The QCA Final Decision should clarify whether **consistent** should read **not be inconsistent with**.

QCA's analysis

Lack of commercial or regulatory imperative

In response to FreightCorp's comments, the QCA considers further development of Schedule E at this stage is inappropriate on account of the fact that the form of Schedule E presented in the Draft Decision was explicitly requested and agreed by stakeholders during the course of the assessment process. Working group meetings will be held as part of a process to develop the standard access agreement.

¹ Section 118(1) (c) of the Queensland Competition Authority Act 1997 (Qld)

Interrelationship between the access undertaking and the QCA Act

The QCA does not consider that QR's Undertaking should include a form of words that allow the arbitrator to make a ruling that departs from the baseline set out in the Undertaking.

First, it would be inconsistent with s119 of the QCA Act, which provides that the QCA must not make an access determination that is inconsistent with an approved access undertaking or access code for the service. Therefore, it may be considered to be an attempt to use an undertaking to amend the QCA Act and would risk being found to be beyond the power of the QCA.

Second, it would inevitably lead to an increase in access disputes arising from the additional uncertainty that would be created should the QCA have the power to effectively overrule the Undertaking on a case by case basis. The rationale for having an approved undertaking is that it provides the baseline for the provision of access, however, the parties are ultimately free to negotiate access on any terms they may require. The provisions in an undertaking will therefore only apply to the extent that the parties are unable to agree.

In addition, as QR's Undertaking will make it clear that the reference tariffs are only applicable to the corresponding reference train service, the QCA understands that s119(1) would not prevent the QCA from making an access determination which was different to the Undertaking in respect of a train service that varied from the reference train services contained in the Undertaking.

With respect to QR's standard access agreement(s), in the interests of certainty, the QCA considers it is preferable that it apply to the extent that the parties cannot agree otherwise and that access determinations be made in accordance with it. However, the QCA recognises that the nature of Schedule E is such that an arbiter will inevitably need to judge the reasonableness of parties' interpretation of the principles in the context of a dispute. This is discussed further in Chapter 8.

Interrelationship between Schedule E and the QCA Act

FreightCorp's request for the QCA to clarify the role of Schedule E is addressed in Chapter 8.

1.7 Undertaking – Content

The content and degree of specification of undertakings may vary from service to service. Ss137(2) of the QCA Act indicates the types of matters to be included in an undertaking. Other matters the QCA may require to be included in an undertaking may be implied from the subject matter, scope and purpose of the QCA Act.

1.8 Undertaking – Approval*Background*

The QCA Act (s138) provides that the QCA may approve a Draft Undertaking only if it considers it appropriate to do so having regard to, amongst other things, the public interest, including the public interest in having competition in markets whether or not in Australia. In addressing public interest considerations in assessing the Draft Undertaking, the QCA considered the factors in Table 1.

Table 1: Public interest considerations

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| <ol style="list-style-type: none"> 1. Promoting competition within a fair and equitable regulatory framework; 2. Ensuring rail safety; 3. Achieving an adequate return on taxpayer's investment; 4. Ensuring regional communities are adequately serviced; 5. Promoting regional development, including economic development and opportunities for employment generation; 6. Legislation and government policies relating to ecologically sustainable development; 7. Social welfare and equity considerations, including community service obligations and the availability of goods and services to consumers; | <ol style="list-style-type: none"> 8. Legislation and government policies relating to occupational health and safety and industrial relations; 9. The interests of consumers or any class of consumers; 10. The efficient allocation of resources; 11. Industrial harmony; 12. The competitiveness of Australian business; and 13. Transitional issues created by reform programs. |
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Source : QCA; QCA Act s76(3); case law; submissions of Queensland Government and the RTBU

Establishing what may or may not be in the public interest required a broad assessment of the factors in Table 1, including balancing what can, in practice, be competing interests. The overriding imperative of the QCA's consideration of QR's Draft Undertaking was that, in total, its decisions contribute to the well-being of Queenslanders.

In considering economic and regional development issues raised by the Draft Undertaking and in the context of the development of reference tariffs for the coal corridors, the QCA commissioned an independent report that examined the potential impacts on the Queensland and national economies of a 30% reduction in the rail freight rate for black coal in Queensland.² The report effectively provided a range of possible outcomes for the reduction, which the QCA labelled as the 'optimistic scenario' and the 'conservative scenario'. For each of these scenarios, Professor Mangan modelled the impact for the State economy of the change, based on assumptions of the impact of the estimated coal production increases independent of any freight revenue losses or royalty gains and alternatively inclusive of the effect of freight revenue losses. The QCA believed the most likely outcome lay somewhere between the two assumptions.

This analysis indicated the potential effects of the 30% rail freight reduction on output, regional income and value added variables based on the mid-point of the two assumptions. The analysis showed outcomes ranging from very substantial benefits (annual average output for period 2002-2010 of \$1038m) to small reduction in state output (-\$75m).

With regard to transitional issues created by reform programs, the QCA acknowledged that a number of the amendments proposed in the Draft Decision would require operational changes by QR, and that there may be cost or other grounds for such changes to be phased in rather than effected in full from the commencement of an approved Undertaking. The QCA balanced the

² Assessment of income, output and employment effects of coal production in Queensland: Professor John Mangan, University of Queensland, October 2000. Volume 4 of the Draft Decision incorporated a copy of this working paper.

need for transitional arrangements against any potential adverse effects on the promotion of competition in the above-rail market.

The QCA proposed a number of transitional arrangements, including the phase-in of efficient infrastructure maintenance costs with respect to reference tariffs on QR's coal network, a six-month period after commencement of an approved Undertaking in which QR would reassign management responsibility of its train control functions at Mackay and Rockhampton and a nine-month period for corresponding changes at Townsville and Brisbane Central. Finally, the QCA proposed a two-year transitional period for QR to develop internal access agreements for its existing services where there are no external contracts currently in place.

The QCA anticipated that the implementation of the arrangements proposed in the Draft Decision would have, over time, a major financial impact on QR. Following the completion of its assessment of reference tariffs in the Draft Decision, the QCA sought submissions on appropriate transitional arrangements.

Stakeholder views

Public interest considerations

QR - the QCA's concerns in many areas revolve around QR's status as an integrated railway, and its approach to dealing with this has typically been to establish prescriptive recommendations regarding the way in which QR conducts its business. While in many such instances QR and the QCA are in agreement as to the importance of the desired outcome, QR considers that certain prescriptive measures proposed (in particular with regard to ring-fencing and pricing) would result in avoidable and unnecessary inefficiencies being imposed upon QR. Where this occurs, the complexity and costs to QR of complying with the Undertaking will increase significantly and, as such, it has the potential to significantly reduce the public benefit of retaining QR as an integrated railway.

In examining the potential public benefit of QR's Draft Undertaking, the QCA has relied upon the premise that the introduction of competition in the coal haulage market would result in a 30% reduction in average rail freight rates for coal in central Queensland. QR does not believe that there is currently any evidence supporting a 30% reduction and nor has the QCA provided any additional evidence in this regard. However, QR is concerned that the current wording of the Draft Decision may create an expectation of an immediate and substantial reduction in freight rates. The QCA has created a situation where market participants may treat this as a benchmark to be achieved, irrespective of whether there are legitimate reasons for prices being established at a different level.

QR has some concerns regarding the fundamental assumptions used in the QCA's analysis of the public benefit of reduced coal rail freight rates. In particular, QR is concerned about the assumption that there will be a direct relationship between decreasing freight rates and increasing volume, as the international coal market is not a perfect market. In addition, QR does not see any evidence of the QCA explicitly considering whether a net public benefit will arise from the myriad of constraints upon the way in which QR conducts its business, particularly when many of these constraints will be felt more widely than the coal industry.

In summary, QR considers the public interest would be better protected under a combined input/output approach which recognises that the most critical outcome is ensuring that QR treats all operators equitably, while allowing QR flexibility in the way in which it operates to achieve this outcome.

QR's proposed review of freight rates will have a significant impact on QR and its shareholders. Therefore, the QCA's suggestion that it may be appropriate to introduce transitional arrangements to spread this financial impact over time has merit. The following would reflect a reasonable transition arrangement for both QR and its shareholders:

- a markup on the track access component of the reference tariffs to the level equivalent to the access charge implicit in existing rail haulage agreements;

- a transparent transition arrangement whereby the above-mentioned markup is reduced to zero over the three year period in which the reference tariffs apply. This could be either by way of a more aggressive CPI-X escalation arrangement or through another similarly transparent mechanism.

RTBU - the QCA is not obliged to undertake any systematic analysis of the ‘public interest’ having regard to the significance of the industry to the national economy, or on ‘national competitiveness’ – but it could have done so. The QCA could also have reviewed issues that the National Competition Council has indicated are fundamental to an analysis of the public interest i.e. ecologically sustainable development, social welfare and equity considerations, the maintenance of community service obligations, economic and regional development, and the interests of consumers. Moreover, the QCA could have applied these concepts to consideration of the interests of all consumers of QR’s services - not just to consumers of coal freight services. Instead, the QCA chose to undertake a narrow review of QR’s Draft Undertaking, focusing on financial and economic considerations, largely from the perspective of access-seekers.

Based on findings set out in the following sections of the RTBU’s report concerning:

- the manner in which the QCA’s determination on access charges will ensure that QR is prevented from earning a commercial rate of return on its investment;
- the consistently biased nature of the decisions embodied in QCA’s Draft Decision on QR’s Draft Undertaking (favouring access seekers rather than the owner of the facilities);
- the manner in which the QCA has gone beyond its role as referee on submissions before it, to assume the role of advocate of major cuts in freight rates (on the basis of the most optimistic forecasts of developments in the coal market)

it is considered that the Queensland Government should urgently:

- review the QCA Act so as to curtail the power of the QCA;
- make its determinations subject to Ministerial review;
- ensure that the QCA has to have regard to the public interest in making its deliberations (including having regard to ecologically sustainable development, social welfare and equity considerations, the maintenance of community service obligations, economic and regional development, and the interests of consumers);
- make the QCA more accountable to Parliament and the community.

The QCA’s claim that it had ‘balanced the interests of QR and access seekers, as well as the public interest’ - was presented without clear analysis of how different interests would be affected by QR’s Draft Undertaking, let alone an assessment of how the Draft Undertaking could produce an ‘imbalance of interests’.

The QCA made no attempt to quantify the impact of QR’s proposals on the profitability of QR itself, or on QR’s capacity to maintain or upgrade its infrastructure, or improve the quality of passenger or other services to communities in Queensland. However, the QCA went to great pains to present argument and evidence supporting the notion that access arrangements would create a major stimulus to the Queensland economy and local employment.

In this process, the QCA overstepped the mark. Instead of acting as an independent referee, the QCA has assumed the role of advocate for the mining industry’s proposals, through the selective assembly of facts and forecasts.

Most of the QCA’s proposed changes to QR’s Draft Undertaking can be seen as contrary to the interests of QR and/or its workforce, or to the Queensland public’s interest. For many of the proposed amendments, the rationale presented suggests that similar conditions could well be imposed on access seekers, not just QR. However, the QCA has only proposed applying the restrictive arrangements to QR. The proposed alternations to QR’s Draft Undertaking only impose costs on QR alone, or make it tougher for QR to compete in the above-rail market.

The QCA has not only failed to consider whether the proposed access regime would provide appropriate incentives for QR to continue to make the substantial investments needed to upgrade and extend its infrastructure – it has also excluded the prospect of prices for rail access incorporating an allowance for the renewal or replacement of existing infrastructure

To the QCA, the QR's control of the operations of the network is a key element of 'vertical integration', and therefore, a threat to competition.

There is an element of confusion between 'means' and 'ends' in the QCA's stance on this issue. The 'end' is the fair and reasonable pricing of freight services, not competition for competition's sake. Experience suggests that the most efficient rail businesses are vertically integrated. On the face of it, vertical integration not only can contribute to the efficient pricing of coal freight services, but also has, in the case of QR, been associated with a high level of productivity.

Moreover, 'vertical integration' can also be seen as an essential element to the safe management of a rail system: the proper integration of management of above-rail and below-rail service delivery, particularly in the area of safety standards.

The QCA's Draft Decision is imposing its views on 'competition theory' without considering how the rail system as complex as QR's could 'best be managed in the interests of efficiency and safety'

The QCA has already done significant damage to QR by incorporating in its Draft Decision an analysis of the economic benefits of third-party access assuming a reduction of 30 per cent in freight rates. Simply providing this analysis has created an expectation in the coal industry that freight rates will be cut by 30 per cent regardless of the actual cost of providing the service.

FreightCorp - supports the QCA's views regarding public interest considerations. It strongly supports the findings of the QCA in relation to the consistency of ecological standards applicable to all rail operators and that the Rail Safety Accreditation Unit of Queensland Transport should deal with rail safety issues.

FreightCorp does not consider that there are any issues of substance to be managed with regard to the re-assignment of train control to Network Access. The proof of this is that QR has already effected the administrative move of train control. In addition, the realignment of the QR below-rail workforce (in the context of the phase-in of efficient maintenance costs and application of incentive regulation) is not necessarily a matter related to the implementation of any particular pricing.

With respect to the interest of consumers, FreightCorp confidently predicts that without an appropriate regulatory environment, competition in vertically integrated environments will not arise. It would be instructive of the QCA to interview the level of satisfaction of rail customers where competition does not and does not exist.

Gladstone City Council - an issue of particular concern is the possible loss of jobs that the RTBU indicates would result from the QCA's decision on the Draft Undertaking and the QCA's draft amendments to the Undertaking. The Council requests the QCA to take a realistic and pragmatic approach and give the issue of possible job losses a large weighting when making its Final Decision.

Jericho Shire Council - the QCA's process completely failed to take account of the public interest in jobs, regional development, fairness, consumer interests and environmental sustainability.

The QCA argues that QR is not an 'efficient rail operator' and that its costs for infrastructure maintenance could be substantially lower, enough to enable it to offer a further 30% cut in rail freight charges. The QCA is basing this on a study comparing QR to the out-sourced Western Australian track-maintenance system. QCA is demanding that QR change its business principles – a full integrated rail system – to meet its test of an 'efficient operator'. The Council considers that the QCA is demanding the privatisation of QR's infrastructure maintenance, and its pricing proposals would harm QR's business to the extent that all of it would be subject to privatisation within a few years.

Other relevant issues

DBCT - acknowledges that while the Draft Undertaking must necessarily deal with contractual matters between the access provider and the access seeker, there should be specific recognition of the obligations to the ultimate client – in the case of coal freight, the coal companies. QR's Draft Undertaking and the QCA's Draft Decision are predicated on consideration of issues affecting the rail system rather than the whole of the coal chain, ie. rail plus terminal. There is an inconsistency between the obligations of port service providers (to optimise coal chain costs) and those of the rail service providers. DBCT recommends that the QCA consider this inconsistency.

The interface between the rail and the terminal is an important determinant of capacity, efficiency and costs for both systems. This affects both operations on a day-to-day basis and future capital expenditure. Day-to-day operational interfaces can be dealt with via protocols. One possibility is to address this generally via the protocols in the standard access agreement and later, more specifically via protocols in the individual access agreement.

The Draft Decision (and the initial Draft Undertaking) does not make clear who will fund capital expenditure at the terminal to expand rail system facilities. The demarcation between terminal and rail accountability needs to be defined.

FreightCorp - is wary of endorsing the concept of a standard set of terms for an access agreement unless those terms are regarded as the minimum that the access seeker can expect, and that QR cannot include unreasonable provisions, in addition to the standard set of terms.

FreightCorp would strongly support, and participate in, a forum convened to work-up detailed standard terms using, as a starting point, Schedule E developed in a manner suggested in our Recommendation 1.

FreightCorp strongly supports the findings and agrees with the assessment of, the QCA in relation to mediation.

Pacific Coal - is concerned about possible conflicts (and cost inefficiencies) because of the focus on the train system rather than the whole of the coal logistics chain from ex-mine through rail and port. The train system is one element of the coal logistics chain from the mine to the point of sale and, while coal rail freights comprise approximately 50 - 75% of total coal chain costs, there are significant capital and handling charges at the port. More importantly, the performance of the port in unloading the coal from trains can have a large impact on train system efficiency, costs and capacity, and vice versa. This is a critical interface that needs to be recognised.

Pacific Coal's interest is in the lowest long-term total coal chain costs, that is, rail (above-track and below-track) plus coal terminal costs. Since the coal terminals in Queensland are currently public monopoly infrastructure assets and these services are likely to be declared at some stage, the implications of this needs to be considered in the QR Undertaking.

As an example, there will need to be consistency between the train operating protocols and the operating protocols at the coal terminals. It is likely that the relevant terminals will need to be directly involved in any access agreement negotiations with third party operators.

PCQ - savings should accrue from efficiencies gained in the provision of a competitive above rail service. However, in establishing the environment for a competitive rail service, parties need to be aware that any savings from improved efficiencies in the above rail service may be more than counteracted by the transfer of costs to other parties such as the owners and/or operators of the port terminals.

The port and rail network has a limited capacity to handle train consists. The greater tonnage carried per consist increases the rail network capacity and the port capacity. If a third party service provider runs a consist with, say, 6000 tonnes of coal compared to QR's largest consists of 9,600 tonnes, PCQ's rail inloading capacity will be reduced. This has consequences for PCQ where the terminal capacity is currently fully committed. A 5% fall in the current 9,000 tonne average consist capacity would result in close to a 5% fall in the rail inloader capacity. At 40 mtpa, this equates to 2 mtpa of throughput and could cause PCQ to invest significant additional capital cost in the terminal. Terminal capacity costs around \$16 million for each 1 million tonne of capacity.

Queensland Government - as noted in the QCA's Draft Decision, its implementation will, over time, have a major financial impact on QR and consequently on the State budget through the State's shareholding interest in QR. The Government is strongly of the view that this potential impact on the State Budget is a matter of public interest which, in accordance with the *Queensland Competition Authority Act 1997*, should be taken into by the QCA in making its Final Decision. If appropriate, the matter should be referred to the Government for consideration of an appropriate policy response.

Stanwell - the QCA could detail the reasons for its Draft Decision more clearly. For example, it should explain what are "inappropriate" entry barriers (or alternatively, when entry barriers are "appropriate"?)

The multi-product nature of "rail services" (eg. provision at different times of day or week, or different reliabilities of supply) also needs expanded comment in the Final Decision, since it has many consequences for pricing and investment decisions by users.

QCA's analysis

Public interest considerations

Competitiveness of Australian business

The QCA has addressed QR's specific concerns about the prescriptiveness of the Draft Decision in the relevant chapters of the Final Decision. In response to QR's argument that the constraints imposed by the Draft Decision will harm the way it does business and increase its costs, the QCA notes that based on consultation it has undertaken in developing the Draft and Final Decisions, this would not appear to be the view of QR's customers.

In response to Stanwell's query about the difference between appropriate and inappropriate entry barriers, the QCA considers that in a regulatory sense inappropriate entry barriers arise where there is no public interest justification. It is not clear how the Final Decision should be expanded to accommodate the multi-product nature of "rail services".

Economic and regional development issues

QR and a number of stakeholders questioned the assumptions and results of Professor Mangan's modelling work that examined the potential impact on the Queensland and national economies of a 30% reduction in the rail freight rate for black coal in Queensland.

The QCA considers QR's concern regarding the 30% reduction in freight rates becoming a benchmark or expectation will be resolved in the above-rail market. There is a range of possible outcomes for coal freight rates in Queensland. The factors which could impact on these rates include industry growth, the achievement of greater efficiencies in the coal chain, the distribution of those gains throughout the chain, fuel costs, and most importantly competitive dynamics within the above-rail market.

The assessment of public benefit required assumptions be made on possible outcomes for the purposes of analysis. The adoption of a 30% estimate, relative to 1999-00 average rates, was based upon independent advice on the above-rail market. However, the QCA was not endorsing this figure as the future expected reduction in coal rail freight rates.

With regard to the concerns expressed by RTBU, and Gladstone and Jericho Shire Councils, the QCA notes that the modelling work undertaken by Professor Mangan suggests there is a probability of net employment growth in Queensland through the positive impact of reduced coal freight rates on State growth. Nevertheless, to the extent that inefficiencies have been identified in QR's current operations, QR and Government have a clear choice as to whether to pursue efficiency initiatives or have that level of inefficiency ultimately reflected in lower returns to the Government as QR's owner.

More generally, the public benefit assessment undertaken by the QCA suggested substantial net benefits from increased coal exports under very conservative assumptions about world coal price forecasts. Current world coal prices are around 13 and 9 per cent higher for coking coal and thermal coal respectively than the prices used in the modelling exercise.

It should also be noted that Professor Mangan's assessment considered a range of outcomes, broadly categorised as conservative and optimistic, including two independent output forecasts, as well as two alternative assumptions regarding QR's ability to secure efficiency gains. The QCA did not endorse any of these outcomes, instead indicating its view that the most likely outcome fell within the range.

RTBU argues that the QCA made no attempt to quantify the impact of QR's proposals on the profitability of QR itself, or improve the quality of passenger or other services to communities in Queensland. However, in its view, the QCA went to great pains to present argument and evidence supporting the notion that access arrangements would create a major stimulus to the Queensland economy and local employment.

The QCA maintains its position in the Draft Decision that an approved Undertaking would create a major stimulus to the Queensland economy and local employment and this is an important public interest consideration worthy of attention. In contrast, it is difficult for the QCA to quantify the impact of its proposals on QR's overall profitability because the focus of the QCA's assessment was QR's declared below-rail services.

The quality of passenger services was not a focus of the Draft Decision because the Queensland Government funds the majority of passenger services in the State under government service agreements with QR. Consequently, the QCA considers that the quality of passenger services is appropriately a matter for the Queensland Government and QR. With regard to improving the quality of other services in Queensland, the QCA maintains its position in the Draft Decision that QR's Undertaking is an inappropriate vehicle to target specific regional development objectives that are better addressed by government policies.

In response to RTBU's concern about competition being a means of achieving a reasonable price for freight services rather than being an end in itself, the QCA refers to its discussion in the Draft Decision on the public interest. In particular, the QCA stated its view that the Queensland and national economies are best served by the development of a regulatory framework for the rail sector that ensures resources are allocated to their most productive use. The promotion of an efficient allocation of resources is closely aligned to the public interest in promoting competition in the above-rail market.

RTBU argues the QCA failed to consider QR's incentive to invest in its infrastructure. The QCA considers the pricing framework it has proposed in Chapter 5 and with respect to reference tariffs, protects QR's incentive to invest. As noted in the Draft Decision, the QCA provided QR with the benefit of a reasonable doubt particularly with respect to the assessment of reference tariffs. In addition, the QCA proposed an explicit consultation process involving QR, system users and other infrastructure service providers to give QR a high degree of certainty that future investments will be recognised in the asset base. This latter issue is discussed in Chapter 13.

Transitional arrangements

In addition to the lower access charges for below-rail services that are likely to result from an approved access undertaking, above-rail charges are likely to substantially fall as well as a result of above-rail competition. This is likely to have a substantial financial impact on both QR and the Queensland Government. The extent and timing of the impact is difficult to estimate because of the different contractual arrangements between QR and the various mining

companies, the timing of the entry of above-rail competitors into the market and the impact of the new tonnages that are likely to result from the new access arrangements.

Notwithstanding the difficulty in estimating its precise extent and timing, the QCA accepts that it is in the public interest for the financial impact on QR and the Queensland Government of the new arrangements to be appropriately managed.

The QCA gave consideration to a “transition path” approach to introducing the new access charges. However, the Queensland Government has indicated that it considers that the best approach is for the QCA to introduce the new arrangements as and when it considers appropriate and for the Government to directly manage any financial impacts itself via its normal budget process. This is an appropriate course of action as the Government is best placed to balance the various issues and interests involved. Accordingly, the QCA has not proposed any financial transitional arrangements.

Other relevant issues

A number of stakeholders raised the issue of the interface between the rail network and port infrastructure in terms of the coverage of QR’s Draft Undertaking. In particular, some stakeholders expressed concern that the Draft Undertaking and the Draft Decision failed to take account of the entire coal supply chain, and instead focussed only on the rail network. For example, Ports Corporation of Queensland noted that, given capacity constraints at the port, there is a risk that savings from improved efficiency in rail service provision may be offset by losses elsewhere in the system.

While the QCA recognises the importance of considering the entire transport chain for coal in terms of the ability of the industry to obtain the benefits of greater competition, the fact remains that QR’s Draft Undertaking applies to the rail network only, and not to port infrastructure. As such, the key issue at this stage is to ensure efficient rail services. Moreover, to a certain extent it is up to the ports to efficiently determine how rail operators interact with them. Consequently, the QCA’s assessment has necessarily focussed on those parts of QR’s infrastructure that are declared and therefore come within the scope of the Draft Undertaking. However, Chapter 16 highlights the importance of assessing efficiencies in the context of the coal chain as a whole. It should be noted that the QCA has previously raised with stakeholders the question of adopting a more formal consultative process to planning and development of QR’s network. However, there was little support among stakeholders for adopting such an approach at the time.

The issue of train scheduling and the port interface can, however, be addressed through the Undertaking. In particular, the QCA recognises the importance of QR consulting the ports when scheduling train services that use port facilities. As such, a requirement to consult port owner/operators in the development of the Master Train Plan (MTP) and Daily Train Plan (DTP) should be included in the Undertaking. This matter is addressed in Chapter 6.