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ABBREVIATIONS

Abbreviation	Full Name
ACCC	Australian Competition and Consumer Commission
ARA	Australasian Railway Association Inc
BTCE	Bureau of Transport and Communications Economics
Carpentaria	Carpentaria Transport Pty Ltd
Council	National Competition Council
CPA	Competition Principles Agreement
FCL	Full Container Load
FreightCorp	Freight Rail Corporation of NSW
Indec	Indec Consulting
LCL	Less than Container Load
Minerals Council	NSW Minerals Council Ltd
NCC	National Competition Council
NR	National Rail Corporation Ltd
NQX	North Queensland Express
PTU	Public Transport Union Ltd
QR	Queensland Rail
QRX	Queensland Railfast Express
RSU	Railway Services Union
SCT	Specialised Container Transport
TPA	Trade Practices Act

1. INTRODUCTION

On 24 December 1996, the National Competition Council (the Council) received an application from Carpentaria Transport Pty Ltd (Carpentaria) asking the Council to recommend that specified rail freight services provided by Queensland Rail (QR) be declared.

Carpentaria, a company incorporated in Queensland, is a wholly owned subsidiary of TNT Limited. Carpentaria provides freight transportation and warehousing services within Queensland. It operates through two principal operating divisions known as

- Queensland Railfast Express (QRX) which provides rail freight forwarding services to its customers using the rail system operated by QR; and
- North Queensland Express (NQX) - which is involved in the movement of freight by road within Queensland and interstate.

Carpentaria moves freight along the coastal corridor extending as far as Cairns by dedicated trains which are operated and provided by QR.

The service is described in the application as “*the linehaul service operated by QR of handling and transporting freight on the routes set out and described in Schedule 1 (of the application).*”¹ A detailed definition of the service and grounds for support of the application are provided in the application.

This statement of reasons deals with the service provided by means of the facilities owned by QR.

Process

After receiving the application, the Council informed QR (the infrastructure owner) and the Queensland Premier (the Designated Minister) of receipt of the application. Staff from the Council’s Secretariat then met with the infrastructure owner and the applicant to discuss the application and the process to be adopted in dealing with the application.

In January 1997, the Council advertised that the application had been received and requested written submissions from interested parties by 7 March 1997. To aid interested parties in preparing their submissions, the Council issued a discussion paper in January 1997.

The Council received 27 written submissions, a list of which appear in the Appendix. Copies of the non-confidential submissions were provided to Carpentaria (the applicant), the Queensland Government, and QR. All parties who had made submissions were advised that the other submissions were available if they wished to consider them.

The Council had originally anticipated making its recommendation to the Queensland Premier on 2 May 1997. However, because a major submission from Carpentaria was received later than had been expected, the Council revised the date for recommendation to 3 June 1997. The applicant, QR and all parties that made submissions were informed of the variation.

The Council considered all the submissions and reached a decision on its recommendation at its meeting of 27 May 1997.

¹ Carpentaria application, p.1

Consultancy

During the course of dealing with the application, the Council sought information on the feasibility of duplicating rolling stock. The Council contracted with DJA Maunsell to provide this information through a short term consultancy. The report provided by DJA Maunsell was treated as another submission and made publicly available. The report formed part of the information considered by the Council.

Confidential submissions

The Council regards submissions as public documents unless confidentiality is specifically requested. The Council is conscious of the need to protect confidential information, including commercially sensitive information.

A number of submissions were made to the Council on a confidential basis. Carpentaria, QR and SCT supplied confidential versions and general release versions of their submissions. The Council accepted the confidentiality request in respect of commercially sensitive information contained in the confidential versions of these submissions.

The Council was disappointed at the inability of the two key parties to this application, QR and Carpentaria, to agree on working arrangements between themselves to deal with issues such as access to confidential information. Overall, the Council found both parties helpful in providing feedback and factual information during its consideration of this application. However, it felt that QR adopted an overly legalistic approach to its participation in the Council's processes.

2. THE APPLICATION

Section 44(F)(1) of the Trade Practices Act (TPA) provides for any person to make a written application to the Council asking the Council to recommend to the designated Minister under Section 44G that a particular service be declared. Regulation 6A of the Trade Practices Regulations requires that an application include certain information.

The Council considers that it received a valid application for the declaration of specified Queensland rail services from Carpentaria on 24 December 1996. The application provides the information required by Trade Practices Regulation 6A.

Good Faith

Section 44F(3) states that “the Council may recommend that the service not be declared if the Council thinks that the application was not made in good faith”.

Some submissions raised the issue that Carpentaria already has access to QR services. An application to seek declaration of a service where access is already provided is not precluded by the TPA. In fact, it is clearly contemplated by section 44G(2)(a) and (f). These provisions refer to “access (or increased access)”.

The Council considers that the criterion “not in good faith” is designed to eliminate trivial applications and those applicants who are obviously vexatious or are applying only to put the provider to the unnecessary expense of responding to an access declaration application. It is clear that this application would not fall into those categories.

The Council has no grounds which would suggest that the application has not been made in good faith in accordance with section 44F(3).

Threshold question

The first issue is whether the services which are the subject of the application come within the meaning of ‘service’ in section 44B of the TPA.

Section 44B of Part IIIA of the TPA defines a service as:

‘service’ provided by means of a facility and includes:

- (a) the use of an infrastructure facility such as a road or railway line;
- (b) handling or transporting things such as goods or people;
- (c) a communications service or similar service;

but does not include:

- (d) the supply of goods; or
- (e) the use of intellectual property; or
- (f) the use of a production process;

except to the extent that it is an integral but subsidiary part of the service.

In order to test whether a particular service is a ‘service’ under the Act, it is necessary to determine that the service is provided by a facility or facilities.

The Facilities

The Application defines the facilities necessary to provide the service as :

(a) Rail infrastructure facilities including access roads, ballast, bearers, signalling equipment between the following locations:

Brisbane - Gladstone - Rockhampton - Mackay

Brisbane - Ingham - Tully - Innisfail - Cairns

Brisbane - Mackay - Proserpine - Bowen - Homehill/Ayr - Townsville

The track is vested in QR by reason of the Transport Infrastructure Act, the Government Owned Corporations Act and the Government Owned Corporation (Queensland Rail) Regulation.

(b) Space at terminals as follows:

(i) Brisbane (Moolabin);

(ii) the QR terminal gantry operations at Rockhampton (Paget);

(iii) the QR terminal gantry operations at Townsville;

(iv) the QR siding at Tully.

The terminal space or equipment set out above is owned or leased by QR.

All rolling stock set out in Schedule 1 is owned by QR.²

The Council recognises there are a number of separate but integral facilities providing the service. These facilities can be grouped as track, above track facilities (including locomotives and rolling stock), and terminals (including loading and lifting equipment).

The Service

While a full description of the service and the relevant infrastructure are set out in Schedule 1 of the Carpentaria application, Carpentaria's submission summarises the service as *"the movement of freight by rail, or the rail freight services market."*³ Access is sought to the Service to promote competition in downstream markets, particularly the freight forwarding market in Queensland. Carpentaria's application describes the service as:

the line-haul service operated by QR of handling and transporting freight on the rail network in Queensland particulars of which are set out in Schedule 1 to this Application.

Particulars of the Service and relevant infrastructure are contained in Schedule 1. By way of explanation:

(a) The service involves the handling and transporting of freight by rail in Queensland including, without limitation:

(i) the carriage of freight by rail between designated places, particulars of which are set out in Schedule 1;

² *ibid*, p.7

³ Carpentaria submission, p.1

(ii) *the loading and unloading of Carpentaria's FCL freight from QR's rolling stock at QR's terminals;*

(iii) *the shunting of trains at Carpentaria's terminals to enable loading and unloading by Carpentaria; and*

(iv) *the temporary storage of freight containers on premises and at terminals owned or operated by QR.*

(b) *The facilities used to provide the service include all infrastructure necessary to handle and transport the customers' freight from terminal to terminal as set out in Schedule 1 and encompasses all facilities necessary to provide the Service in a safe, efficient and timely manner.*

Included within the access declaration sought are both track access and access to above track services. Given the particular situation which exists in Queensland, all elements of the Service are currently so interrelated and integral to the provision of dedicated trains that it is not practically possible, taking into account current regulatory, industrial relations and safety issues for the Service to be divided into track and above track components.⁴

A number of submissions raised as a threshold issue whether the Service is a service for the purposes of Part IIIA of the TPA.

The first question the Council must decide is whether the service in the manner configured by Carpentaria is a service within the scope of the access provisions. This turns on:

whether Carpentaria is seeking access to 'a service provided by means of a particular facility', whether the service is understood as 'handling or transporting goods' or is something else.⁵

Carpentaria argued the definition of the service is valid under sub-paragraph (b) which expressly contemplates the handling or transport of goods as a service for the purposes of Part IIIA. Furthermore, a service may be provided by several facilities. Carpentaria's submission argued that "all of the submissions which take issue with the definition of service fail to refer to sub-paragraph (b) of the definition"⁶.

QR's supplementary submission argues that sub-paragraph (a) is the real focus for access to rail infrastructure. Carpentaria has not sought access to the railway line under sub-paragraph (a) as this would require Carpentaria to provide its own locomotives and rolling stock.⁷ QR takes issue with Carpentaria's definition of the service and asserts that sub-paragraph (b) was never meant to apply to rail, arguing that:

Paragraph (b) was inserted in the definition of service to make it plain that in the context of the access discussions concerning the gas industry and the development of major gas

⁴ Carpentaria application, pp.5-6

⁵ QR supplementary submission, p.4

⁶ Carpentaria submission, p.2

⁷ QR supplementary submission, pp.6-7

*pipelines...and the eastern state's interconnected electricity gridIt was done in that way because 'goods' is defined to include gas and electricity....*⁸

While section 4 of the TPA explicitly includes gas and electricity as “goods” for the purpose of the Act, it does not limit “goods” to only those things listed in the definition, that is, it is not an exhaustive definition of “goods”. There is no apparent reason to limit “goods” in subparagraph (b) of the definition of service in section 44B in the way proposed by QR; “goods” should be given its plain meaning.

Some submissions argued that “the use of a production facility” or sub-paragraph (f) was relevant:

- The Australian Railways Association (ARA) argued the product of a railway is transportation, and the processes by which that is carried out are trains and associated loading and unloading facilities. Other “above rail” services such as terminals, locomotives, rolling stock, shunting and other equipment comprise a “production process” and are unable to be declared.⁹
- The Public Transport Union (PTU) also argued that the use of rolling stock and various QR facilities falls within the context of “a production process” in the sense that it relates to the active aspects of operations which make up service provision, that is, there is a real difference between fixed infrastructure and operational business services. In the cases of electricity grids or gas pipelines, the service consists only of transmission, and not associated business operations.¹⁰

In this case, the Council believes it is highly doubtful that the facility could be considered to be a production facility under paragraph (f) as the facilities generate a service, not a product. There are no new or transformed goods which result from the use of the facility.

Is the service a bundled or composite service

A number of submissions argued that the application seeks to declare a “bundled” service which arbitrarily links essential and non-essential elements, where “bundle” has its plain meaning of a grouping of different things. Carpentaria argues the application seeks to declare a “cluster” defined to be a service provided by a set of facilities which are economically distinct but joined by strong economies of scope.¹¹

QR argues that Carpentaria is seeking access to a set of services and facilities that are bundled together. In particular, QR argues Carpentaria’s application:

*..seeks access not to a facility of national significance but a collection of services and facilities. Drawing together access to track, locomotives, wagons, terminals, lifting equipment, track management services, crew, scheduling, support operations, timetabling, loading and unloading, pinning and unpinning, preparation and completion of documentation, storage, the provision of maintenance and ancillary operations as a bundled package, is simply not within the contemplation of the access arrangements under Part IIIA.*¹²

⁸ loc cit

⁹ ARA submission, p.2

¹⁰ PTU submission, p.11

¹¹ Economies of scope exist where unit fixed costs are reduced by producing more than one product.

¹² QR supplementary submission, p.1

NR obtained legal advice¹³ supporting the view that it is not permissible to bundle facilities which are essential with facilities which are not essential for the purpose of establishing an aggregate service. NR contends that each of the facilities need to be considered separately against the criteria. The service nominated must be unbundled into track infrastructure, line-haul services and terminal services.

FreightCorp argued that Carpentaria's application refers to a composite service, elements of which do not meet the Competition Principles Agreement (CPA) criteria for essential infrastructure.¹⁴

In reply, Carpentaria argued that nowhere in its application is the service described as a "bundle" or is the concept of "bundling" used. Rather, the services to be declared constitute a 'cluster':

The Service consists of a number of components or elements, much in the same way as access to telecommunications services consists of a range of components including switching facilities, line access, etc. In the language of competition access is sought to a cluster of services and not a "bundle". The use of the term bundle in the submissions which have been filed is misleading.¹⁵

"Unless the range of services is declared as a cluster, the market power and entrenched monopoly of QR will remain. The characteristics of the cluster of services to which access ought be granted are that they are sufficient to support the effect, but no more than is necessary to support the effect.¹⁶

Professor Ergas supports the view of Carpentaria that the service derived from the combination of track and above-track facilities for which access is sought constitutes a cluster for the purpose of competition policy analysis. Ergas defines a cluster as a service which is provided by a set of facilities which are economically distinct but joined by strong economies of scope. As a result:

a firm could not realistically supply one component of the cluster without incurring a substantial penalty when compared to a firm which supplied the full line....In the circumstances at hand, the issue is whether a firm which did not own or supply the track could reasonably (that is without significant competitive penalty) supply the above-track services.

The matters to be considered in addressing this question parallel those discussed in assessing the likelihood of duplication. In particular, economists would generally regard it as unlikely that separate supply would occur if such supply entails substantial investments which are (1) specific to the market in question and (2) would make the firm undertaking those investments highly vulnerable to the behaviour of the supplier of those parts of the cluster which it does not control.

It is my view that these conditions are met in regard to the range of services for which Carpentaria seeks declaration...

I would therefore conclude that competition is unlikely to develop in the relevant downstream market if the range of services declared is narrower than that being sought by

¹³ Attachment to NR's submission, National Access regime - Application by Carpentaria Transport Pty Ltd - Advice from Mr Russell Miller, Deacons Graham and James

¹⁴ FreightCorp submission, p.4

¹⁵ Carpentaria submission, p.18

¹⁶ *ibid*, p.15

Carpentaria. Put in other words, it appears to me that the range of services for which declaration is being sought covers those services, and only those services, which are at the heart of QR's current power to exclude competitors. These are the facilities which another supplier is unlikely to be able to duplicate on a commercial basis. Declaring a narrower range of services would defeat the purpose of the Act since separate supply of the excluded services, and hence competition in the down-stream market would not develop.¹⁷

QR's supplementary submission does not accept that the service is a cluster:

This is not an application for a 'cluster' of services in the sense that the term is understood but is truly an attempt to secure access over a bundle of facilities and activities aggregated together.¹⁸

...Importantly, Carpentaria seeks access to all of these facilities and services taken together. This extends the application not just to a service identified in a linked way to a particular infrastructure facility but draws upon all of the above rail operational activities of the corporation. Secondly, the configuration of the service brings together a separate set of facilities through which discrete services are provided to participants in the market for delivery and acquisition of transport logistical services...QR does not accept that a bundling of facilities and services extending to above rail activities, in this way, is properly a service within the access provisions...¹⁹

Part IIIA of the TPA relates to a declared service, not declared facilities. The reason for this distinction is that a facility may provide multiple services, only some of which might satisfy the criteria for declaration.²⁰ Similarly, one service may be provided by a multiple set of facilities.

In deciding whether an application identifies a service under Part IIIA of the TPA, the Council does not consider whether that service, or the facilities which provide it, meet the other criteria for declaration in the first instance. These are two separate issues and both need to be addressed with each application. It is likely that the Council will receive applications which seek access to services which fall within the definition under the TPA but after an assessment of the other criteria, the Council concludes that those services should not be declared. Hence, the Council has not adopted QR's approach of linking the validity of the definition of service to the potential for declaration.

As noted earlier, the Council considers that the transport of goods, as defined by Carpentaria, can fall under the definition of service paragraph (b). It also recognises that there are several facilities which are needed to provide such a service. The issue of whether the service is a "bundle" or a "cluster" is irrelevant to the Council's considerations as the service as defined is subjected to the tests of the declaration criterion. It is important to note, however, that because the regime was designed with access to natural monopolies in mind,²¹ by defining a service which relies on the use of many facilities the applicant does make it more difficult for a cluster/bundle to meet the other criteria in the Act. Section 44F(4), in particular, requires the Council to consider whether it would be economical for anyone to develop another facility that could provide part of the service. This ensures that any cluster of facilities is a legitimate combination which does not push the application

¹⁷ Ergas, H, advice attached to Carpentaria's supplementary submission, pp.15-17

¹⁸ QR supplementary submission, p.3

¹⁹ *ibid*, p.5

²⁰ Draft Guide to Part IIIA, p.17

²¹ *ibid*, p.22

of the access regime beyond that intended. These other issues are considered in detail later in the statement of reasons.

3. EVALUATING THE APPLICATION

The criteria under which the Council must assess the application are contained in section 44F(4) and section 44G(1), (2) and (3). Those sections state:

44F(4) [**Consideration of alternative facilities**] In deciding what recommendation to make, the Council must consider whether it would be economical for anyone to develop another facility that could provide part of the service. This subsection does not limit the grounds on which the Council may decide to recommend that the service be declared or not be declared.

44G(2) [**Council to be satisfied of matters**] The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
- (d) that access to the service can be provided without undue risk to human health or safety;
- (e) that access to the service is not already the subject of an effective access regime²²;
- (f) that access (or increased access) to the service would not be contrary to the public interest.

In respect of section 44G(1), the service the subject of the application cannot be declared if it is the subject of an access undertaking in operation under section 44ZZA.

The criteria detailed in sections 44F(4) and 44G(2) are each considered below.

²² Section 44G(3) requires the Council to consider the relevant principles in the Competition Principles Agreement when assessing whether an existing State or Territory Regime is effective.

3.1 PROMOTING COMPETITION IN OTHER MARKETS

- (a) *that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service*

Approach

The purpose of this criterion is to ensure that access is only granted where there are or will be tangible benefits which flow beyond the service for which access is sought.

To recommend that an application meets this criterion, the Council must be convinced that the service to which access is sought is not in the same market as the market in which competition is promoted.

One way of proving this is to define the market for the service, define the market in which competition is promoted and demonstrate that these two markets are separate. This approach has not been adopted for this application. Instead the analysis focuses on determining that there is a different market in which competition is promoted, rather than precisely defining the two markets.²³

The service to which access is sought will be in a different market from that in which competition is promoted if:

1. The two are in different product markets; or
2. The two are in different functional markets.

The purpose of the national access regime is to allow access to services so they can be used as inputs into other products sold in other markets. Consequently, debate will often focus on the functional dimension of market definition. To conclude that there is another market in which competition is promoted, the Council would need to be satisfied that the outputs at the two stages of the production chain are sufficiently different to operate in different markets. This will require that the customers cannot readily substitute between the two outputs and that suppliers cannot readily move production between the two.

When looking at increases in competition, the Council has adopted the interpretation of “would promote competition” from its Draft Guide to Part IIIA of the TPA which states that “Part IIIA only requires that the action in questions (specifically, providing access to an infrastructure service) would promote competition: while a trivial increase in competition would not satisfy this test, access would not need to substantially promote competition.”²⁴

There was considerable debate between submissions on this criterion. Broadly, this centred around the definition of the market for the service and the “other” market, that is, freight forwarding, and the extent to which declaration would promote competition. The following discussion considers these two issues in detail.

²³ The Draft Guide states that when looking at the definition of the different markets, the Council will take into account a range of factors including the product, geographic, temporal and functional dimensions of the market (p.21) and the long run substitution possibilities in both production and consumption. (p.2, as discussed in *Re Queensland Cooperative Milling Association Ltd* (1976) 25 FLR 169)

²⁴ A Draft Guide to Part IIIA, p.19

1. Market Definitions

The Service

The requirement under criterion (a) that competition be promoted in another market, means that the market in which competition is promoted cannot be the market for the infrastructure service only. It is therefore necessary to ensure that the service falls outside the market where competition is promoted.

Carpentaria's submission contends that there are two markets of direct relevance to the application. The first is the market in which services of rail transport are provided, and the second is the market for freight forwarding services. Carpentaria seeks access to the first of these markets and contends that declaration would promote competition in the second, the market for freight forwarding. The service to which Carpentaria is seeking access is summarised in Carpentaria's submission as "the movement of freight by rail, or the rail freight services market"²⁵.

Pages 11-14 of Carpentaria's application describe the rail freight service market in which QR provides rail services to freight forwarders and others. It argues that while there is some intermodal competition in Queensland there is nonetheless a distinct market for the movement of freight by rail linehaul due to the majority of intrastate freight being forwarded by rail:

QR moved 92 million tonnes of freight by rail in the 1993-4 year and it generated nearly 80% of its total gross revenue from its freight operations.²⁶ In the year ended 30 June 1996 the Coal and Minerals Division hauled 88.7 million tonnes and the Freight Group hauled 7.5 million tonnes of general bulk and containerised freight.²⁷ In some spheres of operation, alternate linehaul choices are available. However, mostly the linehaul method is dictated by the type of freight, the volume, the weight, the destination, delivery times and pricing structures. The existence of some level of intermodal competition does not militate against a separate rail market.²⁸

The Market for Freight Forwarding

Carpentaria identifies the "freight forwarding market" as the market in which competition will be promoted through access. Freight forwarding involves the collection of freight and its delivery to a particular destination. Those seeking to move goods are usually looking for a "door to door" service to be provided and will generally engage others (freight forwarders) to undertake responsibility for managing the total task.

Carpentaria's submission defines the freight forwarder as providing a door to door service which includes:

(a) linehaul for the goods;

(b) a number of constituent elements including pickup and delivery, consolidation and deconsolidation and linehaul; and

²⁵ Carpentaria submission, p.1

²⁶ Rail Freight 1995, International Benchmarking, Bureau of Industry Economics, p.7

²⁷ QR Annual Report 1996, p.9

²⁸ Carpentaria application, pp.11-12

*(c) the freight forwarder taking responsibility for the goods whilst in transit and providing or purchasing whatever transport services are necessary to fulfil the customers' needs.*²⁹

The freight forwarder obtains the linehaul services necessary for it to provide freight forwarding services to customers, and can move its product via a variety of linehaul modes:

*The freight forwarder..acquires those services from providers of rail freight services (such as Australian National), road freight services (such as sub-contractors), sea freight (shipping lines) or air freight (airlines). The participants in the linehaul are different from those in the freight forwarding market.*³⁰

Carpentaria argued that QR sells to freight forwarders a service consisting of the movement of goods by rail which is then an input into the transport logistics service provided by freight forwarders to their customers. This is demonstrated by “..the fact that in Carpentaria’s rail business linehaul cost is approximately 40 percent of the cost of providing the freight forwarding service to customers.”³¹

Carpentaria’s submission therefore summarises the freight forwarding market as having the following characteristics;

- . *it is the market for the provision of those services involved in managing the transport of goods;*
- . *included in the market is the service of purchase of the transport of goods and of taking responsibility for the goods in transit; and*
- . *the management of transport logistics*³²

There are a large number of participants in the freight forwarding market. Carpentaria’s application identifies the main freight forwarders operating in Queensland which use rail and therefore use linehaulage services provided by QR, as Scott Corporation (commonly known as K & S), Toll Freshmark, FCL Interstate Transport Pty Limited, Cubico Boxcar, U.T.O., Liner Trains, Hiles and Pozzolanic. Schedule 1 of Carpentaria’s submission provided a list of freight forwarders which operate in the North Queensland regions covered by the specified trainpaths and the mode utilised by each. The submission notes there are relatively few players who utilise rail.

Analysis of the two markets

As noted previously, the analysis of the criteria for declaration requires the Council to establish whether the service falls outside the market where competition is promoted.

There are a range of aspects which are examined when defining markets. It is likely, however, that in the case of access declarations, when looking at whether competition is promoted in a different market, much of the debate will focus on the functional dimension.

²⁹ Carpentaria submission, pp.6-7

³⁰ *ibid*, p.5

³¹ *ibid*, p.7

³² *ibid*, pp.7-8

The arguments Carpentaria presented to support its claim that there are two distinct markets, fall into two categories:

- First, the rail freight services market is a different market from the freight forwarding market. This issue relates to the functional dimension of the market.
- Second, rail linehaul services are a different market from road linehaul services. This issue relates to the product dimension of the market, and focuses on substitutability between services. The Council has examined the issue of levels of contestability between rail and road in the context of whether access would promote competition in the other market. For example, if rail linehaul services were highly substitutable with road linehaul services, then competition in the other market is unlikely to be promoted as a result of access.

The functional dimension refers to the relevant stage in the production or marketing chain. For example, is there a market for electricity generation, electricity transmission, and for electricity distribution separately, or is there one market for electricity supply. In the case of this application, there has been considerable debate about whether rail freight services and freight forwarding are in the same or in different markets.

Carpentaria seek to establish their case by applying the Ergas tests to establish whether the functional layers constitute separate markets. These tests are:

..whether the layers at issue are in fact separable from an economic point of view. The crucial question here is whether the transactions costs involved in the separate provision of the good or service at the two layers would not be so great to prevent such separate provision from being feasible...

While separability,..., is a necessary condition for distinct functional layers to form distinct markets, it is not sufficient. Rather it must also be the case that serving each of these distinct layers requires assets specialised to that layer, so that supply-side substitution (in this instance in the form of movement from one layer to another) is not so immediate as to effectively unify the field of rivalry within which services at the two layers are provided. The specialised assets at issue may be physical assets (that is, distinct capital equipment), human capital, organisational skills and/or contractual assets more generally (that is, the explicit or implicit contracts required for service to be provided).³³

In applying the Ergas tests, Carpentaria provide the following factors to demonstrate the existence of distinct functional levels between rail freight transport and freight forwarding including:

- *The players in rail linehaul are separate from those involved in road haulage. This is partly for historic reasons, but it is also the nature of railways.*
- *The assets involved in rail linehaul are mainly distinct from those used by road operators. Track and rolling stock in particular, cannot be used for the supply of road haulage services.*
- *Different personnel are involved in rail linehaul and some specialist expertise is involved in each of rail and road linehaul and these specialisations do not overlap.*

³³ Ergas, H. submission in support of Carpentaria's submission, pp.1-3

- *It is not necessary to QR's business that it supply the freight forwarding services which it has chosen to provide through Q-Link³⁴*

Professor Ergas is of the view that the markets identified by Carpentaria clearly meet the two functional dimension tests which establish the services of freight forwarding as distinguishable from the service of rail linehaul. Professor Ergas concludes that:

...there can be no doubt that the services of freight forwarding are distinguishable from those of the supply of line haulage by rail: the mere fact that most market participants in the former do not supply the latter (and vice-versa, QR being an exception in this regard) points to the reality of the distinction. Equally it is also clear that distinct assets are involved: these include specific physical assets (such as warehouses and IT systems), contractual assets (for example, those required by freight forwarders to provide for integrated inter-modal transport), and significant layer-specific human capital and organisational skills. Again, the fact that even QR carries out its freight forwarding through a distinct entity points to the economic significance of the distinction between the layers.

In short, it seems to me apparent that these distinct functional layers form separate markets.³⁵

Many of the submissions³⁶ received including QR, denied the existence of a distinct market for freight forwarding arguing instead for a “market for the provision of general freight transportation and handling services in which participants contest or compete for the ‘door to door’ transportation of freight.”³⁷

QR rejected that there is a separate downstream market for freight forwarding services nor a separate “rail freight forwarding market”.

Indec argued that the market is freight forwarding with rail freight transport being one competing mode. The choice of mode is based on speed, cost, reliability, flexibility and locations served. The freight forwarding market is fiercely competitive among the four modes and within modes and yet despite this competition Carpentaria argued that freight rail transport is a separate market in itself.

QR argued against the use of the Ergas tests on the basis the approach does not appear to be supported by case law, and that “the two-pronged approach appears to be more focussed at determining a point at which to determine whether the layers constitute economically discrete units, rather than assessing whether the nature of competition is such that the layers constitute distinct markets. Ergas’ tests appear to disregard the importance placed on competition as a defining element in market definition...”³⁸ Advice to QR from Professor Phillip Williams also questioned the second condition of the Ergas test as “an attempt to make very precise rules for the functional separation of markets that may not be appropriate in every case.”³⁹

³⁴ Carpentaria submission, p.7

³⁵ Ergas submission, p.3

³⁶ For example, PTU submission pp.19-20, & RSU submission, p.9

³⁷ QR submission, p.2

³⁸ QR supplementary submission, p.21

³⁹ *ibid*, Attachment 2 Commentary by Phillip Williams, p.1

QR argued Professor Ergas' view on functional separation between rail linehaul and freight forwarding services is flawed due to an assumption that QR provides linehaul as an entirely separate functional activity, rather than QR delivering a logistical transport solution to customers:

...Unfortunately, Professor Ergas' commentary does not reflect an understanding of the range of activities and mix of services provided by QR in delivering a logistical transport service to customers within a field of rivalry. Professor Ergas seems to proceed on the footing that QR undertakes linehaul services by rail as an entirely separate functional activity, disconnected from any other set of functional activities, and concludes that there is a difference between that functional linehaul activity and the collection of activities falling within the description of 'freight forwarding services'. The commentary does not seek to identify or define freight forwarding services or the field of rivalry within which freight forwarders operate.⁴⁰

QR instead put forward another test, the Smith and Norman Involvement test⁴¹ as another way of determining functional boundaries. QR cite the test as involving the following steps:

- (a) in the light of the cases, industry conditions, technological and demand conditions, regulations and responses of the relevant economic agents, first set the product and original bounds of a market;*
- (b) then consider an initial explicitly defined functional stage of commercial activity (for example, manufacturing; - in the raw product - manufacture - distribution sequence);*
- (c) then consider what wider range of economic activity would be embraced if the span and scope of the market determined provisionally at stage 2 was to be expanded - that is, expanding the functional domain of manufacturing (for example) forward to embrace distribution, and backward to embrace raw product.*

In order to make that assessment, Smith and Norman propose 2 sub-tests:

- (a) Ask: Do firms or entities operating in the first defined functional domain (eg. manufacturing) have involvements in an extended functional domain?*

If the so-called 'involvement test' is not satisfied, there is no basis for extending the functional bounds forwards or backwards from the first defined functional domain. If the test is satisfied, it is necessary to apply the second test.

- (b) Ask: Is there a significant sphere of influence as between 2 or more functional stages of a production and/or distribution sequence (for example) such that it is not possible to adequately explain the competitive process at one stage without knowledge of the role or influence of individual firms that also operate at adjacent or other stages?⁴²*

QR concluded that the application of the Involvement test to the patterns of behaviour in the market result in no neat, clear functional separation of rail linehaul and all other activities:

⁴⁰ *ibid*, p.18

⁴¹ Smith, R & Norman, N, 'Functional Market Definition'

⁴² QR supplementary submission, pp.19-20

*QR operates or is relevantly involved in a range of activities and the delivery of transport solutions that cross domains.*⁴³

There was also substantial debate about whether QR's current methods of operation provide evidence that rail freight transport and freight forwarding are or are not separate markets.

Carpentaria cited QR's current operations of providing freight forwarding through a separate division, Q-Link, as proof that freight forwarding and rail linehaulage are distinct markets:

*...QR's operating structure belies one aggregate market. To its customers it presents itself in different styles at different functional levels. As outlined earlier QR has separate divisions, such as Q-Link, which operates as freight forwarders in competition with other freight forwarders. This distinction of functional levels appears to be generally glossed over by QR, but it is part and parcel of the way in which QR operates.*⁴⁴

QR's supplementary submission rejects the view put by Carpentaria that QR only operates as a linehaul operator. QR contend that they provide a total logistical solution for clients for which rail linehaul is but one aspect:

...Accordingly, Carpentaria wants to say that QR's only function is to act as a linehaul carrier by rail. That confined function is then said to amount to a separate "market". Since that is all QR does, everything else done by all other participants is a secondary function in a separate "market" (the freight forwarder market)...

*The entire submission fails for the reason that there is no such functional separation. Isolating QR's function to simply linehaul by rail is artificial and the consequent elevation of that functional role to a separate "market" is contrived. QR provides a total logistical transport solution for a range of clients. It is not simply a linehauler by rail. Linehaul by rail is merely one aspect of a total mix of services QR delivers through the deployment of its facilities, staff and operational activities. It contracts with clients to deliver a total transport solution in a wider vigorously contested market.*⁴⁵

QR adds that:

*In fact, QR provides a total transport solution to the needs of customers. An aspect of its activities involves the linehaul of goods by rail. QR sells linehaul services to Carpentaria which in turn provides a total logistics package to its customers. Equally, QR can undertake the prime contract role for the delivery of a total logistical solution and provide the linehaul service together with peripheral tasks such as warehousing and road delivery to the customer's door. Alternatively, QR might contract out or subcontract the provision of aspects of the peripheral tasks...*⁴⁶

QR contends that Q-Link's activities are not evidence of absolute functional separation between linehaul provision and freight forwarding:

⁴³ *ibid*, p.20

⁴⁴ Carpentaria submission, p.5

⁴⁵ QR supplementary submission, p.2

⁴⁶ *ibid*, pp.11-12

Q-Link undertakes what might be regarded as discrete, perhaps historical, ‘traditional’ freight forwarder activities. Q-Link consolidates LCL freight and Express Freight moves this consolidated freight on Express Freight’s wagons and trains. The fact that Q-Link provides a traditional consolidation service of less than container load freight articles is not evidence of absolute functional separation between linehaul service provision and other activities.....QR does not regard itself as a ‘freight forwarder’ in these activities but rather, the provider of a total transport solution.⁴⁷

Conclusion

In assessing whether the service to which access is sought is in a different market from the market in which competition is promoted, the Council needs to establish that it is either:

1. a different product; or
2. the two are functionally separate.

This approach includes elements of the arguments presented by both sides in the submissions.

On the first of these, the Council notes that in many instances, customers would not consider that the service of rail transport is substitutable for a freight forwarding service. Increasingly customers are looking for timing and logistics management in addition to shipment such that the products of freight forwarding and rail transport are different.

Looking at the functional dimension, Ergas’ test provide some useful guidance:

1. Whether it is possible for two separate suppliers to produce the two levels of output. As Ergas puts it, are they separable from an economic point of view.
2. Whether suppliers at the two levels can transfer production from one level to another so that the market outcome is that of competition between the two products. The Ergas test of different assets is designed to address this issue.

As noted above, Carpentaria argue strongly that these two tests are met.

In relation to the specialisation of assets test, QR conceded it is the only provider of linehaul services by rail, and that locomotives and wagons do not operate on roads. QR argued that these matters “simply illustrate that one aspect of QR’s functional activity is not undertaken by anybody else”,⁴⁸ and that the assets involved in linehaul are not dedicated solely to linehaul but to providing a logistical transport solution.

QR refers to the Involvement test and argues that QR’s involvement in both rail freight transport and freight forwarding provide evidence that the two are in the same market.

The discussion of Paul Bugler in advice to NR supports the conclusion that QR is competing “to provide freight transport services to both end users and intermediate service providers (ie freight forwarders).”⁴⁹ In particular:

⁴⁷ *ibid*, p.12

⁴⁸ *ibid*, p.13

⁴⁹ Bugler P, Advice to NR, p.13

Freight forwarders...are essentially logistics managers who consolidate freight for line-haul. At the destination the load is then deconsolidated and delivered to the end customer. In this case, the freight forwarder often has choice about the mode by which freight is sent. Most freight forwarders provide 'in house' road line-haul services as well as logistics management and local pick-up and delivery. When using rail, air or shipping, the freight forwarder is an intermediary between the end user of transport services and the provider. Where the forwarder chooses to use rail, his ability to secure cargoes will be dependent on his comparative advantage with other forwarders who may use other modes. In the main, the end user will be indifferent as to the modal choice provided service and price criteria are met.⁵⁰

It does not, however, follow conclusively that because one company sells two types of services that these are necessarily in the same market. The second of the sub-tests proposed by Smith and Norman recognises this. While involvement may provide evidence of the potential for one market, it also needs to be demonstrated that there are strong links in the behaviour of firms between the two functional stages. Given that many businesses are providing successful freight forwarding services without providing rail line haul, and QR's contention that it does not have influence in the freight forwarding market, these strong links between the two functional levels are not evident.

Application of both the Ergas and the Smith and Norman tests suggest that freight forwarding and rail freight services are in different markets. Submissions from customers such as Woolworths (who have just-in-time refrigeration requirements) support this view.

In conclusion, the Council is satisfied that freight forwarding and rail freight services are in different functional markets. It is worth noting, however, that Carpentaria have moved a lot closer to seeking access to a freight forwarding service by seeking access to the use of other facilities beyond time and space on the track; in particular, the use of such facilities as rollingstock, loading equipment, and terminals.

2. Promotion of Competition in Freight Forwarding

The evaluation of Carpentaria's application under this criterion requires the application of economic principles in order to make a considered judgement as to the outcomes which can be reasonably expected to occur. The application of the test does not require the Council to prove that a sequence of future events will actually take place, but rather to make a considered judgement as to the likely effects of access in respect of the promotion of competition in markets other than the market for the service. This approach is consistent with that described in the Draft Guide.

ARGUMENTS PRESENTED FOR INCREASED COMPETITION

The Council is not required by the criterion to undertake an assessment of the likely impact of Carpentaria's proposals alone. Rather, the Council is required to make an assessment of the impact of access more broadly, on competition in markets other than the market for the service. However, the information provided by the applicant as to how it would operate should the service be declared has been taken into account by the Council.

Carpentaria's application argued that declaration of the service will increase competition in the rail freight forwarding market by:

⁵⁰ loc cit.

- (a) *producing reduced freight movement pricing to freight forwarders with flow on reduced pricing to their customers and lower input costs to a wide range of products including food, beverages and household items;*
- (b) *differentiated service characteristics being available to users of freight forwarding services;*
- (c) *fostering a more rigorous approach to pricing. At present QR sets rates for each freight forwarder (including its own business divisions, Q-Link and Express Freight) and notifies the freight forwarder of the rates applying in relation to a particular Service. There is no competitive process by which the rates are set. The commercial rationale of the current rate structure is not clear and appears to favour QR's own business divisions, Q-Link and Express Freight;*
- (d) *increased efficiencies being introduced to the rail system which in turn will lead to more efficient pricing structures. This will have particular significance for business in country areas of Queensland. It will provide a stimulus for business operation in north Queensland and will provide round trip economies of scale to allow alternative methods for transport of produce from Far North Queensland to Brisbane. This does not presently occur because of QR's refusal to permit return loads to move at marginal cost; and*
- (e) *promote private investment and innovation in the rail system. Road transport in Australia has demonstrated high levels of market responsiveness and innovation in service provision and cost structures. If competition occurs at the level of freight movement it will provide the incentive for this type of innovation in the rail sector. Current QR practices are a positive disincentive to any such innovation.*

Carpentaria is the largest user of QR's non-bulk handling and transportation services. If Carpentaria cannot gain access to the Service it cannot sustain operations as freight forwarder using rail.⁵¹

Carpentaria's submission further elaborates on how declaration of the service will increase competition by:

- *leading to the introduction of increased efficiencies in the rail system with flow on effects to pricing which will provide benefits not only to Carpentaria but others who utilise rail linehaul;*
- *producing reduced freight movement prices to freight forwarders with flow on reduced pricing to their customers, and increasing at the margin the limited substitution possibilities between road and rail;*
- *promote private sector investment;⁵²*
- *allowing a greater level of service differentiation ie increased competition based on quality dimensions of the product;*

⁵¹ Carpentaria application, pp.15-16

⁵² Carpentaria cites the Report of the Queensland Commission of Audit: Volume 2, June 1996, p.153

- *foster a more rigorous approach to pricing;*
- *substantially increasing competition in the freight forwarding industry and in the transport services sector more generally. This is, however, only the first round effect. The benefits of increased competition will be passed onto freight forwarders customers, and can be expected to result in a cost decrease to all user industries. In a large State where transport is a major cost any reduction in this input cost is of national significance. These effects extend beyond the areas directly served by the rail corridor covered by the Application as freight forwarders use the rail terminals as a base for serving inland areas. If there is enhanced competition with demonstrated price-service and product advantages which flow from access, then there will be a clear precedential effect which flows from this application (which QR recognises in its submission) which will, in turn, lead to enhanced competition and improved efficiencies in other sectors, including the minerals sector;*
- *promote innovation in service delivery. Road transport in Australia has demonstrated high levels of market responsiveness and innovation in service provision and cost structures. If competition occurs at the level of rail freight movement it will provide the incentive for this type of innovation in the rail sector. Current QR practices facilitate the abuse of market power by obstructing entry and distorting price. They form a positive disincentive to any innovation either by private operators or by QR itself to improve service levels;⁵³ and*
- *producing a benefit to the Queensland economy as a whole.⁵⁴*

Professor Ergas argued that declaration would materially enhance competition in the freight forwarding market. Competition should be seen as “a process which centres on the active effort (by firms)..to improve the terms on which (they) trade, most notably by reducing costs, developing new products and enhancing the quality of their services.”⁵⁵ Hence the promotion of competition would alter the structure of the freight forwarding market and should be taken to mean “those actions that make it more likely than would otherwise be the case that markets will operate to reduce prices when these are too high, to improve products and to promote technical advance.”⁵⁶

Ergas also argues that declaration would affect market conduct and performance in the direction of greater competition through greater product innovation, including giving freight forwarders the capacity to integrate rail linehaul into service packages:

By its nature, a reduction in the barriers to entry and exit will make it more difficult for prices to attain or remain at supra-competitive levels. No less significantly, Declaration, by improving freight forwarders' access to the line haul services provided by QR, will enhance their ability to compete through innovation and differentiation. In particular, freight forwarders will be able to more fully integrate line haul by rail into their service packages, and to do so while offering a higher grade of service than has previously been available (for example, in terms of service assurance).

⁵³ *ibid*, p.162

⁵⁴ *ibid*, p.153

⁵⁵ Ergas advice, pp.6-7

⁵⁶ *ibid*, p.7. Ergas argues this view of competition is supported in *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (1976) 25 FLR 169

These pro-competitive effects in terms of innovation -- which clearly hinge on enhanced access to the underlying services of line haul by rail for which Declaration is being sought -- are in my view no less important than the impacts on industry structure and on the number of market participants. Indeed, the Tribunal's formulation in QCMA, cited above, recognises (1) that competition through innovation -- that is, through rivalry between firms to develop and offer new products and services -- is of special importance in securing benefits to consumers; and (2) that an increase in the ability of firms to innovate is an increase in the extent of potential and actual competition.⁵⁷

Many of the Ergas comments are reflected in the submissions received concerning how important Carpentaria's services are to business activities conducted in North Queensland. In this regard, submissions received from Coles Myer Supermarkets, Woolworths, Mackay Refined Sugars Pty Ltd, and Carlton and United Breweries indicated that Carpentaria's existing freight forwarding by linehaul of such products as foodstuffs, sugar, and beer have generated benefits for customers in Queensland. Hence, there is the possibility that increased access would also increase competition in the markets for these products which need to be transported to Northern Queensland and are particularly suited to transport by rail.

These benefits have been achieved within the current patterns of access where, in the past, competition has been greatly restricted by Queensland regulations which limited the number of private companies which could provide rail based freight services.

The Council believes that declaration would expand on the benefits beyond those currently gained from limited access. Declaration would make it clear that the approach to the involvement of private rail operators had changed. There would be a strong indication that access was encouraged and therefore operators would be more likely to look at the potential opportunities in Queensland.

QR is currently looking at strategies to reduce costs, increase service quality and develop new innovative services. However, there is considerable evidence across industries in Australia, for example the advances in telecommunications, that shows that greater competition will increase the extent and rate of reform and innovation. Companies are more likely to be highly focussed on the needs of their customers if there are a number of firms supplying similar services or the potential for new firms to move into the market.

The Productivity Commission's submission to the application from Specialized Container Transport (SCT) for declaration of rail lines in NSW notes the benefits competitive pressure may bring to the transport of non-bulk freight:

Benchmarking undertaken by the BIE sheds some light on rails' competitiveness compared to road. The BIE's benchmarking suggests that rail non-bulk freight is currently price competitive with road...However, rail is less competitive in respect to services quality such as reliability. Nonetheless, Australian railways' productivity and quality of service is beginning to slowly improve. If rail operations were operated efficiently in terms of cost and quality (timeliness, reliability etc), their new "efficient" cost structures could make rail a competitive force for many segments of the non-bulk long haul freight market. In this instance, competition from other rail freight operators could well enhance competitive pressures.⁵⁸

⁵⁷ *ibid.*, p.9

⁵⁸ Industry Commission submission, SCT application for declaration of a rail service provided by Rail Access Corporation May 1997, p.21

Such innovation and cost savings would provide benefits to the customers of freight forwarding services, as more service options would emerge through better use of the rail network.

ARGUMENTS THAT ACCESS WOULD HAVE NO EFFECT ON COMPETITION

Several submissions presented reasons why access to the service would not promote competition in the ways discussed above.

High levels of contestability between rail and road

QR submit that the Carpentaria service is in a highly contestable market where prices are constrained by existing competition, and general freight is contested by road and other modes.

There was limited discussion in submissions about the level of competition between rail services and air and sea transport. There is no sea freight service that operates from Brisbane to North Queensland, and the volume of freight traffic moved by air transportation to North Queensland is relatively insignificant. Therefore, for the products relevant to this application, substitution via these modes is not relevant. The bulk of the debate focussed on the level of competition between road and rail freight.

Road and Rail Competition

Carpentaria's application argues the supply of linehaul by rail forms a distinct market from that for the supply of linehaul by road and that competition between the two is limited. Carpentaria outlines factors supporting the existence of a separate market including:

- pricing structures: airfreight is very much more expensive than all other forms of transport; road freight is significantly more expensive than rail on a unit cost basis; and sea freight is cheaper than air, road or rail;
- delivery times with road are quicker than rail, rail delivering according to regular and frequent timetables, and sea freight being slower and irregular;
- road is not capable of supporting the large volume of traffic that would result from a significant shift in the level of freight movement from rail to road;
- no certainty that road transport in Australia is appropriately cost recovered to provide a proper economic comparison;
- the roads of Far North Queensland are not capable of accommodating road freight services at the volumes required;
- a lot of bulk freight is high volume, low value freight which cannot bear higher unit costs of road transport; and
- a growing trend to increase size and volume of unit packages which are transported or to transport freight in an unpackaged form. The larger the unit quantity being moved the greater the relative cost effectiveness and efficiency of rail transport compared with road.⁵⁹

⁵⁹ Carpentaria application, pp.11-14

Carpentaria's submission, drawing on the advice of Professor Ergas, argued that many types of freight using rail linehaul do not compete with road linehaul due to the following characteristics:

(a) the cost of moving by road over the routes relevant to this Application is significantly higher than the cost of moving by rail;

In confidential material provided to the Council by Carpentaria, worked examples were provided to demonstrate the cost differential of moving three major customers' commodities from rail to road. The figures presented show road to be between 64 percent and 204 percent more expensive than rail.

(b) road is primarily a less than container load (LCL) business where the goods to be transported by customers comprise less than a full container load and must be consolidated by the freight forwarder with other cargo for transit with more customers shipping smaller volumes per consignment than is the case on rail;

(c) within Carpentaria's rail business approximately 50% of its business is LCL freight and 50% full container load (FCL) freight;

(d) movement by road involves increased consolidation of individual items;

(e) the nature of the freight which is carried - the average weight per freight note (ie per individual shipment) in Carpentaria's FCL rail business is 9,170kg, in Carpentaria's LCL rail business it is 1,145kg and in Carpentaria's road business it is 430kg per freight note;

(f) rail is the dominant linehaul mode for major customers using Carpentaria's freight forwarding service, where delivery is from warehouses in Brisbane to regional centres. For these customers the rail system carries a significant proportion of their inventory and they are dependent on Carpentaria's just in time service.⁶⁰

Carpentaria argued there are many factors determining the choice of mode, and that while there may be some substitution at the margins between road and rail, there are generally clear cost, time and quality advantages of one mode over another such that a separate rail freight services market exists and the degree of intermodal substitution is limited. Freight forwarders may use the services of different transport markets to provide end-to-end services. Carpentaria states that:

The mode chosen - road or rail or sea - will depend on the nature and volume of the goods to be transported and the time sensitiveness of delivery. At the margins there is a degree of substitution possible between road and rail, so that in some instances freight forwarders face a choice of mode, and may seek to differentiate the service they are providing to the customer on the basis of the mode of transport. In general, however, there is a clear cost, time or quality advantage of one mode over another so that as described and for the reasons set out at pp12-14 of the Application, the level of intermodal substitution is limited.⁶¹

QR strongly disputed the existence of a distinct market for the movement of freight by rail and argued that road and rail are highly competitive. The market for the provision of a transport

⁶⁰ Carpentaria submission, pp.8-9

⁶¹ *ibid.*, p.11

solution is a highly contestable market and that this is demonstrated by: the elasticity of demand in the movement of business between road and rail; there is no evidence that QR has been able to extract monopoly rents or engage in predatory pricing; and that QR is unable to increase prices due to constraints on charges by other suppliers of transport services. QR draws on a report from Sinclair Knight Merz Economics Ltd based on QR's specific market experience, which concludes that:

- . *road and rail are in many cases direct substitutes;*

Changes in the price/quality combination offered by a road or rail service act as an impetus for freight to shift between the two modes of transport.

- . *organisations requiring freight services regard rail and road as competing alternatives;*

Given the common perception of road and rail as competing modes of transport and the common occurrence of freight shifting between modes, it appears incorrect to define road and rail transport as separate 'markets'. The evidence suggests that...road and rail transport are components of the same freight transport industry and are substitutable elements in the total transport and logistics task.

- . *the nature of the 'service package' requested in the marketplace is increasingly moving towards full logistics services as opposed to linehaul operations only;*
- . *improvements in road technology are producing significant cost advantages for the sector (particularly B-doubles vehicles) in competing with and gaining business from railways;*
- . *rail operators...are experiencing losses in market share to road transport operators; and*
- . *neither road nor rail are charging monopoly rents.*⁶²

Indec and QR provided additional extensive material on intermodal competition:

- Indec contend that intermodal competition is fierce with any significant change in price resulting in immediate realignment of market share between modes. Only road transport offers a total door-to-door service.⁶³
- QR contend that the market in which it operates is the highly contestable market for the delivery of a total transport and logistical solution to clients. QR is restricted by the size of its own road fleet, but is partially dependent on road transport. Road freight is already fiercely competitive and has a majority share of Queensland freight market and should rail operate on full cost recovery, more freight would transfer from rail to road.⁶⁴

In addition, in advice obtained by NR, Bugler argued that there are no impediments to the carriage of cargo by road with the exception of coal which requires a special permit from the Queensland

⁶² *ibid.*, pp.14-15, SKM Economics pp.20-21

⁶³ Indec submission, p.5

⁶⁴ QR supplementary submission, p.2

Department of Transport. At the same time, the maximum load on heavy road vehicles has been progressively raised.⁶⁵ Road rates are normally more expensive than linehaul rail rates, although the differential is much less pronounced on a door-to-door cost basis. In 1994, rail freight rates on the major interstate corridors were on average about 23 percent less than road rates. This was seen to be accounted for by service differentials between the two modes.⁶⁶

There appeared to be general agreement that there is some level of competition between road and rail services. However, there was disagreement about the extent of that competition and whether it was sufficient for access in rail transport to have an impact on competition in the freight forwarding market.

As noted above, Carpentaria argued that for the types of products it carries, the levels of competition between road and rail transport is low. It's submission also argued, using the analysis of Professor Ergas, that the rate of substitution between the two services is not high:

..I recognise that there is a range of freight for which road and rail are substitutes. However, what is relevant for market definition is whether they are such close substitutes that users of line haul service can with little penalty by way of additional current or capital cost shift from one mode to another. Absent such easy and relatively prompt substitution, the alternative of hauling goods by road will not discipline the market power of a sole supplier of haulage by rail.

The historic pattern is itself significant in this regard. In effect, what has been observed is not the prompt substitution which characterises the discipline of competition within an area of close rivalry, that is, within a market; rather, it is a secular trend in which (according to the submission by Indec) the relevant "proportion of freight rail transport to all freight forwarding transport has steadily declined in Australia"⁶⁷....

Confirming this analysis, the process of substitution seems to have been pushed to the point where virtually the only rail traffic left faces few realistic alternatives. Thus, all serious analysts agree that even at current conditions, line haul by road is not an efficient and effective substitute for line haul by rail for a substantial group of commodities. This is most obviously the case for relatively dense, low-value goods not needing transport at high speeds and/or requiring transport over distances in excess of 600 kilometres. I understand from material provided by Carpentaria in support of its submission that freight of this kind now accounts for the bulk of that it carries in the areas covered by this Application. I also understand from that material that shipping the freight in question by road would entail a very substantial cost penalty.

Moreover, it is also apparent... that the scope for further substantial road/rail substitution in the areas covered by Carpentaria's application is seriously limited -- for example, as a result of constraints on further expansion in the road network⁶⁸

In contrast, QR and others argued that the level of competition between road and rail is high. QR provided the following:

⁶⁵ Bugler, P, Advice to NR, p.15

⁶⁶ *ibid*, p.13

⁶⁷ Indec submission, p.5

⁶⁸ Ergas H, p.4-5

Carpentaria says that this issue of contestability and substitution is not the point. The real test, it says, is ‘whether there is so much substitution and so quick substitution that a firm which was the sole supplier of a particular range of those goods or services could not profitably and durably raise price (or degrade quality) above the competitive level’. If that test is intended to mean that there must be instantaneous substitution (‘so quick substitution’) it of course ignores the law as the High Court has made it clear that substitution possibilities are to be measured in the “medium and long run”. In any event, the market experience of QR is that it loses business (which is the fundamental test of contestability and substitution) on a transactional basis, either by tender or contract to other market participants in the normal course of business activity.⁶⁹

Conclusion

As several submissions noted the comparisons necessary to determine the level of substitutability between road and rail transport are not straightforward. Professor Laird⁷⁰, for instance, pointed out the difficulty in obtaining a proper economic comparison between rail and road transport. The results will very much depend on the characteristics of the road and rail systems in the region and the nature of the freight being carried.

The National Planning Taskforce January 1995 study “Building for the Job”, identified that it is possible for there to be a distinction between the markets for road and rail transport. Commissioned Work Volume 1 argued that while there may be some substitution in linehaul, this is likely to occur in only a small number of cases due to substantial differences in the types of freight each mode is suited to carrying. The BTCE noted the following:

...the proportion of freight that could be induced to switch modes by changes in prices or service levels over the relevant range is not great. Modal changes involves matching the attributes of the mode with the requirements of the consignment. Each mode offers a package of service attributes - cost, transit time, frequency, reliability. Consignors will have widely varying preferences determined mainly by the type of freight and the distance to be transported...⁷¹

and concluded that:

...there is little scope for substitution between the modes. Each mode has its own strengths and weaknesses in terms of the combination of price and quality attributes it can offer and freight consignors will have widely varying preferences determined mainly by the type of freight and distance to be transported. Much freight is captive to one mode for the relevant range of prices and qualities offered by the mode. It is only in limited segments of the freight market where consignors preferences are such that two modes would be alternatives and a price or quality change would cause a switch.⁷²

⁶⁹ QR supplementary submission, p.16

⁷⁰ Professor Laird argued that road transport in Australia is not appropriately cost recovered and the present National Road Transport Commission (NRTC) heavy vehicles charges distort road rail competition and the long haul freight market. He noted the Industry Commission have previously stated that some heavy vehicles meet less than 20 per cent of attributed costs, and that differences between charges and road-related costs are greatest for vehicles competing with rail.

⁷¹ National Transport Planning Task Force: *Building for the Job: Commissioned Work, Vol 1 BTCE Report*, Jan 1995, p.117

⁷² *ibid*, p.124

There are, however, other studies which point to areas of strong competition between road and rail transport in the non-bulk freight market segment. However, the extent of inter-modal competition varies between commodities and between transport corridors.

The Council's view is that there is competition between road and rail transport and, in some cases, high levels of competition for some products currently transported on QR's network. However, this competition is not sufficient coverage to result in road and rail being good substitutes for all of the service for which Carpentaria is seeking access.

There are several reasons for this conclusion;

- Data provided by QR and Indec indicate the average distances of products carried by rail was 260 kilometres compared with an average 92 kms for road. Carpentaria is required to move goods over average distances in excess of 600 kilometres on what is one of the longest rail corridor (1700 kms) in Australia. The one-way haul distances of the three line-haul trains providing the service are Brisbane to Mackay - 980 kms, Brisbane to Townsville - 1,357 kms, and Brisbane to Cairns - 1,697 kms.

The distances Carpentaria is transporting freight are well within those distances suited to rail transport.

- The timing of delivery and the characteristics of the service required by many of Carpentaria's customers are suited to rail transport.
- Carpentaria has also demonstrated a range of circumstances where the costs of road transport would be considerably higher than for rail, as noted previously, between 64 percent and 204 percent.

The Council believes that competition will be promoted, particularly for those products which are highly suited to carriage by rail transport. In considering future rail applications, the Council will need to examine the scope for road to be an effective substitute for the commodity and/or trainpaths specified in determining whether competition will be promoted in the other market.

Carpentaria already has access

QR argued that Carpentaria already has access to the North Coast line such that competition will not be promoted or circumstances changed. The set of services and facilities over which access is sought are those that are actually used now. Carpentaria has not substantiated how the benefits claimed will occur by reason of a formal declaration recommendation.

SCT also noted that Carpentaria has access, and QR has not denied access. SCT contend it is difficult to see how granting access through declaration would promote competition. At best, Carpentaria's application would merely preserve the status quo. Accordingly the application fails the test of promoting competition in at least one other market.

The Council accepts the view of Professor Ergas that declaration will lower the barriers to entry and exit for other third party access, as well as for Carpentaria. Therefore, access would be expected to place additional pressure on both QR and Carpentaria to provide the best services possible, both in the rail freight and freight forwarding markets.

The Service is Carpentaria specific

SCT and the RSU argued the service to which access is sought is Carpentaria specific. If access is granted, Carpentaria will be able to service its existing market. Its investment in terminals and customers would make it difficult if not impossible for anyone else to obtain access to the service. Only Carpentaria could make use of the service.

Submissions also argued that access is sought to a particular linehaul container service already dedicated to Carpentaria, operating an established timetable and using facilities for which Carpentaria has paid substantial money. Carpentaria would have complete access under terms negotiated under Part IIIA due to QR's agreement with Carpentaria to dedicate the train route.

The RSU argued that any increase in competition would be trivial as Carpentaria seeks access to the current service which QR already provides. There will be no increase in competition on the corridor as no new competitor will be entering the market, and no new services are proposed by Carpentaria.

QR also contended the application seeks the declaration of 8 locomotives and 245 container wagons specifically to Carpentaria, and that there is no basis for an access declaration requiring the owner of a facility to dedicate a part of those facilities permanently to a third party.

The process of declaration gives a right to a third party to negotiate the terms and conditions of access. It does not give a right of exclusivity to specific trainpaths. The process of declaration is made for a specified period of time and, as such, does not confer a permanent right of access. Furthermore, the declaration process merely creates an enforceable right to negotiate access; and arbitration if required.

The Council's consideration of the declaration of this service does not specify the number of locomotives or wagons. It is looking at types, not numbers, of rollingstock. Therefore, it would be open to the Arbitrator of a dispute to require the expansion of capacity (at the cost of the access seeker) to accommodate additional rail operators.

Access may not result in lower prices

QR submitted that the real issue between QR and Carpentaria is the negotiation of new prevailing charges and, as such, this application is a de facto prices oversight mechanism. If the services are already available, is the application a genuine extension of those services or an attempt to cover the field of activity with a new regulatory prices mechanism?⁷³

QR argued that access would not promote competition as it is assumed that Carpentaria's costs will fall as a result of access when they could rise if QR was to apply full cost recovery and commercial rates of return. Similarly, the ARA argued that access may not necessarily lead to lower freight forwarding rates due to the access charges Carpentaria may have to pay. QR stated the following:

...prices clearly will not fall because QR must achieve greater levels of cost recovery before prices can be reduced. The cost base of Carpentaria will rise because of the increased access price it must pay QR. Either Carpentaria must incur the capital cost of procurement of the additional facilities or QR will, by a declaration, be compelled to acquire the facilities and the capital costs must be met as part of the access fee by Carpentaria.⁷⁴

⁷³ QR supplementary submission, p.24

⁷⁴ *ibid*, p.5

This argument pre-judges the issue and is not relevant to any criterion considered by the Council. The terms and conditions of access are reached in negotiation between the parties and if no agreement can be reached, by arbitration. In addition, prices alone are not the only factor which would result in greater competition in freight forwarding.

There is strong competition in freight forwarding already

Submissions argued that there is already substantial competition in the freight forwarding market, which is unlikely to be enhanced by declaration.

The ARA provided the following:

It is difficult to accept Carpentaria's argument that its application will satisfy this criterion by increasing competition in Queensland in either freight forwarding or the movement of freight by rail. Carpentaria competes in the freight forwarding market with a number of other freight forwarders in Queensland who are able to use line haul services provided by Queensland Rail (QR) or other modes. The line haul services provided by QR must compete for freight forwarders' business with air, road and sea services.

Consequently, the freight forwarding business in Queensland is already highly competitive with a range of freight forwarders having a range of transport alternatives. This ensures that the services provided by QR to freight forwarders are competitive with other modes.⁷⁵

Supported by a memorandum account of advice obtained from Professor Phillip Williams, QR asserted that the freight forwarding market is highly competitive already and barriers to entry are likely to be low. Further, QR asserted that the issue is whether there would be an increase in competition in the freight forwarding market as a whole, rather than the competitiveness of Carpentaria:

Carpentaria's argument seems to be not that access would make the structure of the freight forwarding market more competitive. Rather, Carpentaria seems to be arguing that a declaration would enable Carpentaria to extract cheaper prices for an input (rail services) and that this would make Carpentaria more competitive. That is, Carpentaria's argument on competition relies on a confusion between the state of competition in a market and the competitiveness of a single enterprise. Accordingly, in deciding on the effect of competition on the freight forwarding market as formulated by Carpentaria, the NCC needs to be satisfied that a declaration of access would change the structure of the whole freight forwarding market so as to increase competition in that market as a whole.⁷⁶

The Council was of the view that access to QR's facilities provides the potential for new train operations to provide rail freight transportation services which could be expected to intensify rail competition for freight. New train operations will increase diversity and capacity in rail linehaul, promoting a more competitive freight forwarding market. The opportunity for increased competition to substantially impact on the non-bulk freight market will be enhanced if there are segments of this market which see rail as the preferred transport mode.

⁷⁵ ARA submission, p.1

⁷⁶ Williams. P, Andrew Greenwood memorandum, p.4

The Council believes that rail is the only viable transport option for much of the freight carried by Carpentaria and other freight forwarders, and thus concludes there is prima facie evidence to support the view that access arrangements could increase competition in the freight forwarding market.

Carpentaria has market power

QR argued that Carpentaria has significant market share and market power in rail and road resulting in access entrenching Carpentaria rather than stimulating competition. In particular:

There is no basis for concluding that reduced prices to Carpentaria from QR (assuming reductions in prices occurs by reason of access - which will not occur) will be passed on. Rather, Carpentaria is likely, in QR's view, to consolidate its own position.⁷⁷

QR contended that Carpentaria enjoys more than 50 percent of the road freight task on the North Coast corridor. It moves approximately 65 percent of all "rail forwarder" freight into Gladstone, Rockhampton, Mackay, Townsville and Cairns. It has 25 percent of all rail freight (excluding coal and minerals) on the North Coast Line. QR therefore argued:

...in QR's view, access will have the effect of entrenching Carpentaria's existing dominant position and consequent market power in the road sector. In QR's view, the Council should give careful consideration and great weight to the particular market position Carpentaria enjoys in the road sector as compared with other road linehaulers and logistical transport service providers. This matter clearly affects the question the Council must decide of whether it is probable that competition will be promoted in the downstream market...⁷⁸

FreightCorp submitted that access would not promote competition in rail freight forwarding, but merely entrench Carpentaria's position in the wider non-bulk freight transport market.

The Council acknowledges that Carpentaria is a significant player in the freight forwarding market in North Queensland, but does not agree that Carpentaria has significant market power. Carpentaria is one of many freight forwarders who operate in Queensland. The Council is not convinced that Carpentaria is so dominant in the market that it would be able to retain all the benefits from access from flowing at least in part to consumers, that it could prevent existing operators gaining access to QR's linehaul services in order to expand, or that it could prevent other players from entering the market.

The Market definitions are incorrect and hence access will not promote competition

Several submissions argued that there is no separate market for the movement of freight by rail and hence access cannot promote competition in a different market from the service. Carpentaria has not demonstrated that competition would be enhanced in any separate market.

The Council has considered this issue in the context of its discussion of market definition in the preceding section and has accepted the two markets as defined.

Small scale of general freight operations

⁷⁷ QR supplementary submission, p.5

⁷⁸ *ibid.*, p.36

Professor Laird submits that of QR's 26.37 billion tonne kilometres of freight in 1995-96, only 4.15 billion tonne kilometres was for general bulk and containerised freight. He questions whether national benefits would arise from subjecting a small dispersed rail freight task to competition from a new private rail operator.

The Council again stresses that the terms of access are automatically available to other third parties. Given that some products are specifically suited to rail transport, improvements in rail services do have the potential to flow through into freight forwarding.

Abuse of market power

Carpentaria and QR both argued that the potential for competition in another market is affected by the other party's use of its market power;

- Carpentaria argued that access would reduce QR's ability to use its market power in rail transport and freight forwarding generally.
- QR argued that access would entrench Carpentaria's monopoly position and that Carpentaria would exploit that position.

Both parties deny that they have monopoly power or that they would act in a way to exploit that power.

The access provisions in Part IIIA of the TPA were not set up to address the issue of abuse of market power. This issue is covered under Part IV of the TPA. The Council believes that it would be inappropriate to use Part IIIA to address issues of market conduct. Similarly, an applicant's potential or otherwise to be involved in anti-competitive behaviour is an issue which should be addressed under Part IV, not under Part IIIA.

Conclusion

The Council considers that this application meets this criterion. The increase in competition is unlikely to be large but it would be non-trivial. The Council agrees that declaration of the service would promote competition in a market other than the market for the service by improving the prospects for entry, innovation and market structure in the freight forwarding market.

The Council has concluded that access to the services provided by the QR facilities will result in improved competition within the market for freight forwarding. Increased competition is likely to be reflected in:

- increased cargo volumes, increased efficiencies and lower costs in freight forwarding;
- choice to freight forwarders which will encourage improvements in service and potentially lower prices; and
- the potential for new entrants providing a complete transport service, including new entrants to rail transport.

The increase in competition will not directly affect all aspects of the freight forwarding market. The evidence provided suggests there is already a substantial level of competition in much of the freight forwarding. For most non-bulk freight it would appear that, at this stage in the reform process, road freight transport places a cap on rail freight rates.

However, the Council is satisfied that the opportunity for increased rail competition to impact on the non-bulk freight market will be enhanced for those segments of this market that see rail as the preferred transport mode. The Council believes that rail is the only viable transport option for many of the types of freight carried by Carpentaria and other freight forwarders, and thus concludes there is evidence to support the view that access arrangements would promote competition in the freight forwarding market. Similarly, if substantial improvements were made in the efficiency of rail operations, an access regime could enhance competitive pressures in the transport of all non-bulk freight.

In coming to this view, the Council would note that for future rail applications a case-by-case examination of the intermodal effects on competition will be required to determine where road may be considered as a competitive alternative. Overseas studies focussing on competition in freight transport suggest that rail transport faces relatively strong competition from road transport in the non-bulk freight market segment. However, the extent of inter-modal competition varies between commodities and between transport corridors. If non-bulk rail freight rates are substantially influenced by the price and quality of road transport, then the ability for rail access to promote competition in the freight market may be limited.

FreightCorp argued that competition could be promoted in rail freight forwarding if access was granted to rail track only. Consequently, new entrants could compete in rail and through differentiated options in non-rail operations.

The Council agrees that providing access to the track only would increase the benefits from access by providing greater scope for innovation in above rail services. It does, however, believe that there are some benefits available through increased competition in freight forwarding available from access to the service as defined by Carpentaria.

3.2 DUPLICATING THE FACILITIES

(b) that it would be uneconomical for anyone to develop another facility to provide the service

S44F(4) In deciding what recommendation to make, the Council must consider whether it would be economical for anyone to develop another facility that could provide part of that service. This subsection does not limit the grounds on which the Council may decide to recommend that the service be declared or not be declared”.

In the draft guide to Part IIIA of the TPA, the Council stated that “the policy intent underlying the access regime is to focus mainly on what economists call ‘natural monopoly’ situations. While the focus is on natural monopolies, there may be other situations where it could be uneconomical to develop another facility, and where the facility provider is an entrenched monopoly.”⁷⁹

As discussed in the introduction section of the reasons, the service to which Carpentaria has sought access is provided by a number of facilities.

Criterion 44G(2)(b) requires the Council to consider whether it would be uneconomical for anyone to develop another facility(ies) to provide the service as a whole. As QR points out, the Council is not required by the criterion to undertake an assessment of whether it is uneconomical for Carpentaria to duplicate the service. Rather, the Council is required to make an assessment of whether it is uneconomical for “anyone” to reasonably develop another facility to provide the service.⁸⁰ However, the information provided by the applicant as to the magnitude of the costs of duplication has been taken into account by the Council.

Additionally, the Council is also required under section 44F(4) to have regard to whether it would be economical for anyone to develop another facility that could provide part of the service. Consideration of whether it is possible to develop a facility to duplicate part of the service is most likely to arise where two or more facilities provide the service which the applicant seeks to have declared. The Council’s approach will be to identify those features of the facility which make it difficult for anyone to achieve economic returns on their investment. The Draft Guide identifies monopolies as a situation where this is likely to occur. If one of these facilities could be economically duplicated, then declaration cannot be recommended.

When considering how to divide the service for consideration under section 44F(4), the Council is conscious that it needs to balance:

1. the risk of incorrectly recommending declaration because monopoly facilities have been bundled with those operating in competitive markets, with
2. incorrectly recommending against declaration because a very small part of the facility is theoretically possible to duplicate. For example, it would be possible for someone to build 10 metres of rail line, but it would be ridiculous to reject an application for declaration based on that possibility alone.

It has been necessary for the Council to determine some guidelines for dividing facilities which provide the service into parts for consideration under section 44F(4).

⁷⁹ Draft Guide, p.22

⁸⁰ QR supplementary submission, p.37

The Council agrees with the statement by Henry Ergas that:

*the key question must be whether it is likely that an actual or potential market participant would find it commercially worthwhile to duplicate the facility in question*⁸¹

It is likely that part of the service will be commercially viable to duplicate when either:

1. the service is provided by several separate facilities; or
2. the service has a number of component parts which could be separated. For instance, some infrastructure facilities can be used for several purposes. If an application for declaration covers a number of those purposes, it would be legitimate to consider each purpose separately when assessing whether it is possible to develop another facility that could provide part of the service.

In relation to this application, the service is defined as a rail transport service. It is clear that this service is provided by multiple facilities. As the service is defined in this case by linking it to rail infrastructure the issues arising under the second test above will also involve consideration of the ability to duplicate the facilities. As a result, it is necessary for this analysis to consider:

- whether it is uneconomic to develop another facility to provide the total service; and
- whether it is uneconomic to develop another facility to provide part of the service.

Many of the submissions focussed their discussion on these criteria, though often they concentrated on the ability to duplicate part of the service, namely the rollingstock and terminals.

Duplication of the Facilities as a whole

In relation to criterion 44G(2)(b), Carpentaria argued that if the only means of entry into the market required the duplication of all facilities necessary to provide the service, then the barriers to entry would be so high as to prevent new entrants from commencing operations.

Carpentaria detailed what it would need to acquire to provide the service itself.⁸² This includes acquisitions of corridors of land throughout Queensland through purchase or lease to construct the necessary track and associated infrastructure such as terminals, establishing appropriate systems to obtain accreditation as a railway operator, acquiring locomotives, rolling stock, lifting and shunting equipment. Carpentaria estimates that the capital investment required to duplicate the facilities (excluding track) to be \$90 million and that given the current revenue generated from the service, it would not be possible to generate a positive rate of return on that level of expenditure.⁸³

Carpentaria contend the track is expensive to construct with best estimates showing a cost of \$1 million per kilometre. Terminals are also expensive, costing anywhere between \$500,000 and \$12 million depending upon size and requirements at the particular location. Carpentaria also detailed extensive safety, regulatory and operational schemes associated with operating rail services.

Another factor identified by Carpentaria is that the service is characterised by high exit barriers which arise principally from the extensive investment required and the lack of any alternative use

⁸¹ Ergas advice, p.11

⁸² Carpentaria application, pp.18-19

⁸³ Carpentaria submission, p.22

for such facilities. Its submission stated that because QR does not have the same track gauge as other States, the capital assets required to provide the narrow gauge service in Queensland are specific to the state further increasing the costs (and risks) of entry.

Carpentaria further contended that there is spare capacity in the facilities identified to provide the service:

In addition to the direct financial cost of duplication of facilities to provide the service, a relevant consideration under this criterion is the capacity of the existing facilities to provide the Service. QR currently has not only the capacity to provide the Service (as it currently moves all of Carpentaria's rail freight), but has excess capacity and is looking to increase the volumes of freight moved by it within its existing capacity.⁸⁴

The dedicated trainpaths nominated move freight from Brisbane to areas of far north Queensland. The population levels in these areas are relatively small. The application argued that the infrastructure required to service this small population is extremely large and cannot be economically duplicated. Nor can these areas be effectively served by road transport without major investment in the road network.

None of the submissions argued that it is possible to duplicate the rail facilities necessary to provide the whole service, primarily because it is not possible to duplicate the rail track. The Council agrees with this view.

Duplication of Part of the Facility

Carpentaria provided a number of arguments and analysis based on the work of Henry Ergas which presented the case that the facilities are highly integrated and that it would not be possible for Carpentaria to duplicate part of the service.

Carpentaria's application provided the following in relation to facilities:

(b) The facilities used to provide the service include all infrastructure necessary to handle and transport the customers' freight from terminal to terminal...and encompasses all facilities necessary to provide the Service in a safe, efficient and timely manner.

Included within the access declaration sought are both track access and access to above track services. Given the particular situation which exists in Queensland, all elements of the Service are currently so interrelated and integral to the provision of dedicated trains that it is not practically possible, taking into account current regulatory, industrial relations and safety issues for the Service to be divided into track and above track components.⁸⁵

Carpentaria's application did not argue that the facilities which provide the service can never be economically duplicated, but rather they cannot be economically duplicated in the timeframe for which declaration is sought given the characteristics of the Queensland rail freight market and QR's position in that market. In particular, locomotives and wagons would require 18 to 24 months to construct, terminals would have to be constructed, and accreditation obtained.⁸⁶

⁸⁴ Carpentaria application, p.20

⁸⁵ *ibid.*, pp.5-6

⁸⁶ Carpentaria submission, p.21

Carpentaria argued that the “cluster” of services for which access is sought is the minimum required to enable effective competition in price, product, and service packages offered to customers.⁸⁷ It contends that if all of the services were not declared, it would not be possible for Carpentaria to get access at all. Carpentaria’s submission states:

*...that if access to the track only was granted, QR could...be expected to behave in such a way as to make any grant of access ineffective...by predatory pricing and its control of barriers to entry.*⁸⁸

As previously discussed under criterion (a), the issue of abuse of monopoly power in relation to availability of rollingstock and terminals is an issue for Part IV rather than Part IIIA of the TPA. However, section 44ZZ(1) under Part IIIA does prohibit the provider or user of a service to which a third party has access under a determination from engaging in conduct for the purpose of preventing or hindering third party access to the service. Sections 44ZZD and 44ZZE of Part IIIA empower the Federal Court to enforce this prohibition by granting injunctions on parties engaged in such conduct.

The relevance of the declaration period when considering the potential for duplication

In relation to the issue of the time period for which access is sought and the requirements of criterion (b), the Council does not accept Carpentaria’s contention that the test of whether it is uneconomic to duplicate the facilities needs to be based on whether a rate of return can be made within the declaration period sought - in this case seven years.

As QR points out, a third party could seek access to facilities and specify an unrealistically short period of time, say two years, in which it could not repatriate the costs of investment, and hence the facilities would obviously be uneconomic to duplicate. QR provides;

*The test is whether Carpentaria has approached the investment on an “economic footing” and that means, whether, Carpentaria is applying recognised benchmarks in its investment decision-making. This investment needs to be committed for 20 years and the issue of whether the facilities can be economically duplicated is to be determined across the economic life (20 years) of the investment...the question of economic duplication must be judged against international benchmarks for investment in rail infrastructure.*⁸⁹

The Council has not decided on a particular time period to apply when assessing a commercial rate of return, but it agrees that it should be based on industry standards and not the period of declaration. It notes that the expiry date for declaration does not mean that access necessarily reverts back to the previous terms and conditions. It is open to anyone to apply to have the service redeclared. The Council will recommend such a declaration if the services and facilities which provide those services still meet the criteria.

Assessment of the facilities

Many submissions argued that it is economically feasible to develop another facility to provide part of the service. The discussions in the submissions focus on four areas:

⁸⁷ *ibid*, p.15

⁸⁸ *ibid*, p.22

⁸⁹ QR supplementary submission, pp.41-42

- track;
- above track facilities including locomotives and rollingstock;
- terminal facilities and loading equipment; and
- impact of factors such as safety accreditation.

The arguments presented differ on each of these areas. The following sections discuss each area in turn.

An important aspect of the Council's analysis is that section 44F(4) requires that it consider whether it is economically viable for anyone, not specifically Carpentaria, to develop another facility to provide part of the service.

Track

All of the submissions accepted that the track facilities are uneconomic to duplicate. QR's submission states:

There is little doubt that duplication of track and related land and signalling for the purpose of forwarding general freight is uneconomical.⁹⁰

QR's supplementary submission further contended that an application for access to the track alone "might be competent" as it is not economically feasible to duplicate the track:

Access is not intended to operate in highly contested non-natural monopoly markets. This is not a proper matter for an access declaration. If, on the other hand, the application was made for access to the track and the service of operating the track so that Carpentaria could run a train on the track, that application might be competent. QR concedes that it is not economically feasible to duplicate the track.⁹¹

Carpentaria estimated the cost of duplicating the track to be \$1 million per kilometre.⁹² In advice obtained by NR, Bugler believes this figure to be too low when associated structures such as bridges, tunnels, and signalling are included. Bugler believes that \$1.5 million per kilometre is a better estimate, and that this would represent an equivalent annual cost of \$175 million per annum, treble the available revenue.⁹³

On the basis of these estimates, it is clear that:

...neither, from a commercial point of view, is there an incentive to duplicate the (track) infrastructure, nor from an economy wide view, is it desirable that the infrastructure be duplicated.⁹⁴

⁹⁰ QR submission, p.35

⁹¹ QR supplementary submission, p.3

⁹² Carpentaria application, p.18

⁹³ The basis of these figures are contained in Bugler P, Advice to NR regarding Carpentaria's application, p.6

⁹⁴ Carpentaria submission, p.24

Bugler notes that track infrastructure most closely resembles a natural monopoly in circumstances where the volume of traffic is limited. Track is capital intensive to construct, tends to have surplus capacity, and the capacity is very “lumpy” with additional track providing additional trainpaths.⁹⁵

The Council recognises the track involves substantial fixed costs (many of which are sunk), and relatively low variable costs. The Council accepts the view that the track facilities are uneconomic to duplicate for the service.

Above Track Facilities including Locomotives and Rolling Stock

While all conceded the rail track is uneconomical to duplicate, many submissions⁹⁶ argued that the ancillary facilities identified are not. While access to track does include access to those ancillary facilities necessary and inseparable from the use of the track eg, signalling, it does not include those above rail elements identified such as locomotives, wagons, loading and unloading, and shunting facilities whose supply are available through purchase or lease.

In relation to duplication of rollingstock, Carpentaria’s submission contends that the service as defined displays monopoly characteristics that render it uneconomic to duplicate:

In strict terms these characteristics are diminishing marginal costs and declining average costs over the relevant range of output. This is due to the existence of fixed costs for the delivery of the service. Rolling stock and locomotives may display constant marginal costs, however, this is only one component of the costs required to provide the service. Also required are maintenance facilities, shunting facilities in a number of different locations, storage facilities for rolling stock, accreditation and regulatory costs, management systems, and staff/crew training costs.

These fixed costs mean there are significant economies of scale in operating train services (a declining average cost curve). Carpentaria contends that, in the Queensland market, these economies extend over a range that encompasses the market’s demand for the service...

...There are also considerable sunk costs with any investment in rolling stock. Notwithstanding a second hand market for narrow gauge rolling stock, the high costs of transporting railway equipment, especially overseas, means that second hand sales will not be commensurate with the purchase price. There are thus substantial exit barriers in the market...

In summary, it is neither commercially viable for Carpentaria to duplicate this service, nor would it be efficient from the community’s point of view to duplicate the facilities as total costs of satisfying the market would rise.⁹⁷

It is Carpentaria’s view that QR has and will continue to have economies of scale and scope which are not available to Carpentaria. These are such that:

⁹⁵ Bugler P, advice to NR, p.11

⁹⁶ Professor Kolsen, QR, Indec, NR, FreightCorp, SCT, RSU and PTU

⁹⁷ Carpentaria submission, p.25

*...even if Carpentaria was to get access to track and terminals but not rolling stock, it would be faced with capital expenditure of \$90 million in an environment where there are enormous sunk costs and long lead times before the equipment came on stream.*⁹⁸

Other submissions disagreed. QR and Indec argued there are many precedents to demonstrate 'above rail' facilities are economically feasible to duplicate. In particular:

- Companies such as Westcoast Rail and TranzRail have acquired or leased locomotives and wagons.
- **Second-hand rolling stock** is available from QR, AN, Westrail and TasRail and from private refurbishers such as Morrison Knudsen. In excess of 600 locomotives in the national fleet are narrow gauge vehicles, of which Indec and QR expect at least 200 to become surplus in the next few years. However, over 60 percent of that fleet is over 15 years old. In relation to wagons, approximately 50 percent of the national fleet are narrow gauge. Second-hand wagons cost between \$25,000 and \$60,000, and locomotives between \$500,000 and \$2 million to purchase.

In advice to NR, Bugler quoted the 1996 ARA Yearbook which provides numbers of narrow gauge locomotives in public railways in Australia. In 1996, QR had 508, Westrail had 58, and AN had 47.

- **New rolling stock** can be obtained from Australian and overseas suppliers including Goninan, Evans Deakin, Clyde Industries and Adtranz, many of which operate in Queensland. New locomotives on average cost approximately \$3 million to purchase. To lease, new locomotives cost between \$500,000 and \$750,000 per annum or \$2.50 to \$4 per kilometre. Approximately 300 new wagons per annum are constructed for state systems to replace ageing stock, at a cost of \$100,000 per wagon.
- In terms of **exit barriers**, rolling stock is readily saleable at any time provided that in the case of leased equipment, appropriate provisions are made in the lease documentation. Most terminal equipment would have a ready second-hand market also.⁹⁹

The extent to which the Rollingstock facilities are Queensland specific

Indec, QR and SCT refuted Carpentaria's claim that narrow gauge is specific to Queensland requiring the purchase of narrow-gauge rollingstock which represents an unacceptably high cost of entry. An Indec survey calculates there is 19,420 kilometres of narrow gauge in Australia and New Zealand of which Queensland has 9,300 kilometres. Western Australia, Tasmania, the Eyre Peninsula in South Australia, and parts of South East Asia operate on narrow gauge. QR has recently sold refurbished rolling stock to Vietnam, and is offering narrow-gauge expertise to Taiwan.¹⁰⁰

SCT claimed it is not difficult or expensive to construct new narrow gauge rolling stock. Further the costs of leasing the appropriate rolling stock is only a minor part of total costs of providing Carpentaria's service.¹⁰¹ FreightCorp argued there are established markets to source rolling stock

⁹⁸ *ibid*, p.90

⁹⁹ Indec submission, pp.11-13

¹⁰⁰ *ibid*, pp.14-16

¹⁰¹ SCT submission, pp.3-4

and ancillary services in Far North Queensland and Western Australia, and therefore it is feasible and economic to duplicate rolling stock.¹⁰²

The RSU argued that the Council should not declare access outside the track as all other facilities including staff, locomotives and rollingstock are readily available in the marketplace.¹⁰³

Is Rollingstock economically feasible to duplicate

Carpentaria's submission provided some expert advice by Mike Purcell of G13 Pty Ltd on the availability of rollingstock. Purcell identifies QR's contentions on whether each of the rollingstock facilities are uneconomic to duplicate and provides comments on each. In turn, QR's supplementary submission provided expert comment from Indec on Purcell's observations. The Council has examined each of these issues in turn.

- (a) "Above rail" assets and associated systems cannot be considered "facilities" as contemplated by the Act, because they are not in the nature of a monopoly.

Purcell argued QR can supply the service more cheaply than Carpentaria and other small operators separately, and that "even if access to the major physical items of track, locomotives and rolling stock are available, the scale and complexity of above rail support need for even one service makes it uneconomic for a small operator to duplicate."¹⁰⁴ An example cited of the scale penalty faced by small operators is the cost of arranging coverage for breakdown en route. The Carpentaria service covers long distances, and it would be prohibitively costly for Carpentaria to emulate QR's rescue facilities. Small scale may also result in less efficient utilisation of locomotives and crew.¹⁰⁵

In reply, Indec detailed a number of precedents eg, Westcoast Rail where small operators have obtained access to track to operate freight services and have acquired second-hand rollingstock and achieved integration of resources. Those services which cannot be provided by an operator could be provided as a paid service under contract. This is the case with emergency recovery services which can be provided by QR as a contracted service. Multiple operators may also pool emergency recovery capacity, resources and costs. Start-up operators may also hire accredited drivers from QR or other railways on a contracted basis.¹⁰⁶

The Council considers that breakdown and other services can successfully be obtained through service provision contracts.

- (b) New locomotives can be either purchased or leased

Purcell argued that Carpentaria would pay a higher price than QR for the additional 8 locomotives required to provide the service due to the relatively low order quantity. Furthermore, Carpentaria would have to allow for 2 reserve locomotives, one for maintenance downtime and one as insurance to provide the service if an operating locomotive became unavailable. This equates to an additional 25 percent investment compared to the 10 percent locomotive reserve capacity operated by QR.¹⁰⁷

¹⁰² FreightCorp submission, p.5

¹⁰³ RSU submission, p.11

¹⁰⁴ G13 Advice to Carpentaria's submission, p.1

¹⁰⁵ *ibid*, pp.1-2

¹⁰⁶ Indec "Comments on Attachment 2 of the additional submission from Carpentaria", pp.1-2, Schedule 4 QR supplementary submission.

¹⁰⁷ G13 Advice, p.3

Indec, Bugler and Purcell broadly agreed the cost of a new locomotive to be approximately \$3 million. Indec noted that new locomotives require very little maintenance in the first 10 years with routine maintenance conducted outside of operation times such that various small operators have succeeded in achieving near full utilisation. Similarly, emergency locomotive hire may be arranged by separate contract or under a track access regime. New locomotives may also be purchased on a 'power-by-the-hour' basis where the supplier provides the maintenance.¹⁰⁸

Clyde Engineering conceded the purchase of a small number of new locomotives would result in a higher cost per locomotive, however this does not mean the option is uneconomical. The economics depend on many factors including potential earnings per locomotive, and Clyde Engineering is currently negotiating the manufacture of similar or smaller orders with a number of other private operators indicating that small quantities can be viable. Furthermore there is also the capacity to purchase new locomotives from Clyde Engineering and Goninan as an extension of an existing build order thus reducing the additional cost penalty of a small order. Clyde Engineering also submitted that only one locomotive would be required as a spare rather than two. Carpentaria could also potentially work with only 8 locomotives if maintenance was scheduled during periods of low usage.¹⁰⁹

On the evidence, the Council considers the costs for a new entrant to purchase or lease new locomotives need not be considered prohibitive.

(c) The market for second hand locomotives is well supplied with 200 locomotive expected to become surplus. Second-hand locomotives could be refurbished.

Purcell argued there is negligible supply in the current Australian second hand narrow gauge locomotive market. Any locomotives that became available are unlikely to be suitable due to age (old stock means high maintenance costs, low reliability, and poor fuel efficiency) and price. In regards to refurbishment, Purcell estimated the refurbishment cost of a surplus locomotive to be approximately \$1.5 million, and believes the process takes as long as purchasing an order to construct new locomotives and results in an inferior product due to fuel efficiency and maintenance cost.¹¹⁰

Indec argued the comments on refurbishment are not valid. TranzRail of New Zealand refurbish and overhaul 25 year old locomotives complete with fitting turbo chargers at an approximate cost of \$NZ600,000. QR is considering overhauling 60 locomotives along these lines.¹¹¹

QR argued the market for narrow gauge locomotives is well supplied with Westrail currently advertising the sale of 10 surplus locomotives and an additional 31 to go on sale later this year, as well as scope to purchase from overseas sources such as South Africa.¹¹²

In relation to refurbishment, Clyde Engineering submitted that suitable secondhand locomotives can be purchased for \$150,000 - \$300,000 and significantly upgraded for an outlay of \$500,000 - \$750,000. Refurbishment can cost as much as \$1.5 million claimed. Given an average

¹⁰⁸ Indec "Comments on Attachment 2", p.2

¹⁰⁹ Attachment 6, QR supplementary submission, Letter from Clyde Engineering, p.1

¹¹⁰ G13 Advice, pp.3-4

¹¹¹ Indec "Comments on Attachment 2", p.3

¹¹² Qr supplementary submission, pp.44-45

refurbishment cost of \$0.75 million and \$0.3 million for purchase second hand, this would represent 50 percent of the cost of a new locomotive.¹¹³

However, Clyde Engineering conceded that “the real issue is finding suitable locomotives for the refurbishment.”¹¹⁴ Clyde Engineering acknowledged Purcell’s reasons and concluded:

*It is true that Carpentaria is unlikely to obtain second hand locomotives. The availability of second hand narrow gauge locomotive is limited in Australia and those available are generally not suited for mainline freight usage...Also, neither the Westrail or AN locomotives would be immediately suitable for QR operation due to restrictions in Queensland’s rollingstock gauge and driving position.*¹¹⁵

The Council considers on the evidence presented that the purchase or lease of second hand locomotives is less likely to be a viable option for new entrants.

(d) Carpentaria could purchase new wagons

QR and Purcell agreed that the cost of a new container wagon to be approximately \$95,000, and that the provision of the service will require an additional 245 BCZY wagons.

Purcell argued the capital charges associated with investment in new wagons would place Carpentaria at a significant economic disadvantage compared with QR. QR has negligible capital charges on its wagons because many are fully amortised. Furthermore, the technology of new versus old wagons does not generate the significant differential in performance that new versus old locomotives does.¹¹⁶

Indec argued that QR’s fully amortised wagons are of such an age to render the rollingstock less productive than new wagons, and that the costs in productivity of old rollingstock negates the advantages of negligible capital charges.

QR argued the market for the design, construction and supply of suitable wagons is very competitive with a current surplus in capacity in Australia.¹¹⁷ QR sought the advice of Clyde Engineering and A. Goninan & Co Ltd. Clyde Engineering confirmed that rollingstock can be economically feasible for an order of 8 locomotives and 200 BCZY wagons to reflect the necessary economies of scale. In relation to container wagons, an economic order would be for 100-200 wagons. A recent contract to NQEA Australia for 26 wagons indicates the number of wagons required for an order can be significantly less than this. Goninan confirmed that an order of 200 BCZY wagons would achieve the required economies of scale to receive the same unit price as that offered to QR.¹¹⁸

The Council does not consider the costs of new wagons to be prohibitive for a new entrant, and the evidence suggests the market is competitive for the supply of new wagons.

(e) QR estimate that of its 38,000 wagons, 10,000 are or will become surplus

¹¹³ Attachment 6, QR supplementary submission, Letter from Clyde Engineering, p.2-3

¹¹⁴ loc cit

¹¹⁵ loc cit

¹¹⁶ G13 Advice, p.5

¹¹⁷ QR supplementary submission, p.45

¹¹⁸ Attachment 8, QR supplementary submission, letter to Goninan

Purcell argued that this generic number of wagons is irrelevant as the issue is the number of narrow gauge container wagons that are surplus. Of these, QR's rollingstock is fully utilised, Westrail runs no narrow gauge container trains, and TasRail container wagons are unlikely to be available. Furthermore, sales overseas would have to bear transport costs.¹¹⁹

Indec conceded the economics of second-hand wagons and parts versus new wagons favours the acquisition of new wagons and argues the cost of acquiring new wagons is not prohibitive. QR believes surplus wagons are available overseas. However, the availability of secondhand wagons is not relevant due to the viability of new wagons.¹²⁰

The Council agrees on the evidence that it is unlikely that surplus container wagons will become available and that this is unlikely to be a viable option for new entrants.

(f) QR submit that narrow gauge equipment is no barrier to exit because there is demand for this equipment outside of Queensland.

Purcell argued narrow gauge specifications reduce the resale proceeds of container wagon contemplated by Carpentaria. TasRail is the only other narrow gauge system with significant container traffic. The TasRail system is small and highly unprofitable and hence TasRail would be unlikely to purchase container wagons at other than distress prices. Purcell, Indec, and Clyde Engineering agreed the economics of converting narrow gauge wagons to standard gauge are prohibitive.¹²¹

Indec contended that there are ample opportunities to sell second-hand narrow-gauge container wagons overseas, and that salvaged parts could be used on other wagons other than containers.¹²²

The Council considers that the market for second hand narrow gauge wagons is more restricted than that of standard gauge rollingstock. However, the limited availability of secondhand rollingstock tends to indicate that there is demand for these wagons. Rail access is likely to increase the depth of that market.

The costs of extending the Rollingstock facilities

QR estimated the capital outlay to establish the additional rolling stock required to provide the service to be 8 locomotives, 245 container wagons and an information technology system for a total cost of \$50 million. QR argued that this is economically duplicable due to economies of scale:

These facilities can be economically procured and the economies of scale are such that they can be procured just as easily by Carpentaria (utilising the resources of the TNT Group) as QR...These facilities currently do not exist within QR and...an access declaration would require QR to go to the market and engage in a procurement process for the construction of 8 locomotives, 245 BCZY container wagons and an enhancement of the information technology system.¹²³

Indec calculated the establishment cost of duplicating rolling stock for the Carpentaria service nominated as \$45 million total to purchase new locomotives, wagons and shunting, or \$19 million

¹¹⁹ G13 Advice, pp.5-6

¹²⁰ Indec "Comments on Attachment 2", p.4

¹²¹ G13 Advice, p.6

¹²² Indec "Comments on Attachment 2", p.5

¹²³ QR supplementary submission , p.41

for second hand rolling stock. Alternatively, rolling stock could be leased for \$10 million per annum for new rolling stock or \$5.2 million for second hand rolling stock.¹²⁴

Bugler estimated the establishment cost of duplicating rolling stock for the Carpentaria service nominated as \$60.8 million comprising \$35 million for new locomotives, and \$25.8 million for new wagons. Carpentaria's schedule 1 indicates the wagons are intended to be captive to its traffic, but the locomotives are not. Bugler concludes the costs of duplication would be recoverable from the revenue currently available.¹²⁵

Conclusion

The Council recognises the validity of a number of the points presented by Carpentaria. In particular:

1. The quality of second hand rollingstock which is currently available is poor and is limited in supply.
2. It would take 18 months to 2 years to build new rolling stock.
3. QR is a large player in the market and currently owns the bulk of the rolling stock available in Queensland.

However, it does not believe that these factors are sufficient to warrant the declaration of rolling stock.

Drawing on the range of expert advice provided in relation to this application, the Council believes that there are a range of options for providing rolling stock which could be used to supply all or part of the needs of Carpentaria or any new entrant into the market. These include:

- purchase of second hand rolling stock;
- purchase of new rolling stock;
- leasing (second hand or new);
- conversion of standard gauge equipment to narrow gauge; and
- continuing to lease from QR.

The economics of each of these options will vary depending on the particular service being provided. In relation to the expert advice provided, the Council considers that the purchase or lease of new locomotives or wagons, and the provision of breakdown and other ancillary services through paid service contracts are economic for third parties to duplicate.

The issue of whether QR would deny access to this rolling stock to damage Carpentaria's business is more appropriately addressed under Part IV of the TPA, or sections 44ZZD and 44ZZE as previously discussed (p.33).

As Bugler argued:

¹²⁴ *ibid*, p.14

¹²⁵ Bugler, P, Advice to NR, p.9

It was always assumed that the most likely area of competition within the railway sector was the provision of alternative train services. As the new entrants who have already entered the market have shown, there are ways of doing so without necessarily making extensive investments in rolling stock and personnel training. However, one could expect that any long-term participant would find it advantageous to ultimately acquire the assets and skills in-house to provide what must be seen as core business functions.¹²⁶

The Council has concluded that rollingstock is economically feasible to duplicate.

Terminal facilities and loading equipment

Carpentaria argued the existence of excess capacity at current terminals means it is uneconomic to duplicate terminal facilities as the existing facilities are sufficient to service the entire market.

A number of submissions argued that Carpentaria owns or operates all but two of the terminals currently used for the service demonstrates that large parts of the facilities are economical to duplicate:

The notion...that Carpentaria cannot duplicate these facilities is curious since Carpentaria already has access to or operates all of the terminal facilities identified...and enjoys the benefits of utilising those facilities in acquiring the relevant services from QR and is able to economically duplicate the remaining facilities¹²⁷

Carpentaria explained that the development of its own terminals is a product of a historical condition of entry imposed by the Queensland Government and is not indicative of whether terminals are currently economic to duplicate. Carpentaria's submission stated the following:

There is currently duplication of terminals which has been brought along by the conditions of entry imposed by the Queensland Government in permitting freight forwarders to use the rail system. By way of example, Carpentaria's Woree terminal could easily handle all QR volumes in Cairns. At present, this type of duplication is increasing unit costs to all spheres where rail freight transport is an input. A failure to declare all the facilities will lead to increased distortions in what is already a highly distorted market. The arguments noted...in relation to track and rolling stock apply equally to the terminal facilities over which access is sought. Terminal facilities involve monopolistic characteristics.

The QR submission nowhere disputes that the current terminal facilities are adequate to handle the access sought by Carpentaria. It argues from past experience however that Carpentaria can economically duplicate the terminal facilities. This assertion is not correct for two reasons:

- 1. Carpentaria's involvement in terminal facilities has a specific historical context and does not bear on the question of whether facilities can be duplicated today (or in the foreseeable future)*
- 2. Excess capacity at terminals means that it is not commercially viable for Carpentaria to duplicate the facilities.*

¹²⁶ Bugler, P, Advice to NR, p.12

¹²⁷ QR submission, p.44

It is the existence of significant excess capacity at current terminals that renders it uneconomic to duplicate the facility. This is another way of saying that the terminals are sufficient to serve the entire market. In addition, QR possesses significant locational advantages for existing facilities which means that if facilities were duplicated the entrant would suffer compared to the incumbent.

So in fact the efficiencies which would flow from QR providing access would result in lower overall input costs.

Looked at from Carpentaria's point of view, it would be incurring significant sunk costs to add to already excess capacity. In this situation Carpentaria would not be able to earn a commercial rate of return on its investment.

From an economy-wide point of view it would be a misallocation of resources to invest in additional capacity that is not necessary.

Carpentaria contends, therefore, that the characteristics of the service, high sunk costs and already excess capacity make it uneconomical to duplicate terminal facilities.¹²⁸

The Council has examined the material and believes the fact that Carpentaria operates some of its own terminals is not conclusive proof that terminals are economic to duplicate. The Council accepts that the existing terminals are in part a product of a historical condition of entry into the Queensland market. The Council accepts that over the years this factor impacted on the development of terminals in such localities as Gladstone, Mackay and Townsville as a result of changes in the service offered by QR.

SCT argued there is ample land on the Brisbane-Cairns corridor to develop new terminals and contend the cost of duplicating terminals are not uneconomic compared to the size of Carpentaria's business. SCT contends there may be some instances in high density cities such as Sydney where non-availability of land located next to track makes the development of an alternative terminal impossible. However, this is not the case in Queensland where only minor land distances are required to be out of the city environs.¹²⁹

The RSU argued that the building or leasing of infrastructure such as terminals should be seen as normal costs which are a part of commercial activities whether on rail or road and should be duplicated as they are by other rail operators in other states.¹³⁰

Where there is existing duplication of QR and Carpentaria terminals eg, Rockhampton, Townsville, Mackay and Gladstone, QR argued both terminals are essential, and that each could not accommodate the other's traffic due to congestion. Furthermore, separate terminals allow for specialisation, in that Carpentaria and QR can install facilities which allow value adding to their business.

In Rockhampton and Townsville, QR currently handles Carpentaria's containers. QR notes that for Carpentaria to move to full containerisation, new terminals would need to be constructed at these

¹²⁸ Carpentaria submission, pp.27-28

¹²⁹ SCT submission, p.3

¹³⁰ RSU submission, p.11

locations. QR estimates new terminal construction costs can reach \$10 million, and note that Carpentaria's Woree terminal cost in the order of \$8.5 million.¹³¹

The most detailed analysis of the costings of terminals was made by Bugler who contends the average cost of a non Brisbane terminal to be \$2 million, and the Brisbane (Moolabin) terminal to be \$12 million. Bugler calculates the total cost of the 12 terminals outlined in Schedule 1 of the application to be \$34 million. Bugler concludes that the level of cost compared to potential revenue "is certainly within the level that a business might be prepared to undertake."¹³²

In its application, Carpentaria defined the facilities required to provide the service as space at QR terminals at Brisbane (Moolabin), terminal gantry operations at Rockhampton (Paget) and Townsville, and the siding at Tully.¹³³ Using Bugler's costings, this would result in a total duplication cost of \$18 million.

In relation to lifting equipment, QR argued these can be leased or purchased (either new or secondhand) from a variety of suppliers and can be used in both the road and rail industries. QR already leases 2 locomotives to Carpentaria for shunting purposes at Carpentaria's Woree terminal and shunt tractors and indexers can be used as an alternative to locomotives for shunting. Forklifts cost approximately \$750,000. QR estimated that approximately \$15 million would be required to build private stabling yards, sidings and lifting equipment, supplemented by hire access charges at most locations of approximately \$2 million per annum.¹³⁴ Indec also submitted there is a thriving second hand market for lifting equipment, and that new equipment is not uneconomical to duplicate.¹³⁵

Conclusion

Bugler in his analysis of the costs of terminals notes the availability of land in most regional Queensland centres, and the relatively low costs to establish terminal facilities. In particular he notes that:

In most provincial Queensland locations, land suitable for a rail terminal will be relatively cheap assuming that the freight forwarder does not seek to set up in the centre of town. It is quite feasible to use modest facilities for smaller volumes of traffic and infrastructure such as concrete pavements and high volume lifting equipment are not always required. Land for a terminal in Brisbane would be expected to be far more expensive unless the forwarder was willing to locate a long distance from the industrial areas.¹³⁶

There are alternative terminal sites already in operation in Brisbane, and there are several other sites which have been identified as potential rail freight terminals....terminal costs do not form a prohibitive element in the transport chain. This would indicate that

¹³¹ QR supplementary submission, p.40

¹³² Bugler P, Advice to NR, p.10

¹³³ Carpentaria application, p.7. QR provide that the Moolabin terminal is operated by Carpentaria on land owned and leased by QR. Carpentaria uses Tully General Carriers to operate the Tully terminal on QR land which is not leased to Carpentaria. The handling of Carpentaria's containers is carried out by QR at QR's Rockhampton and Townsville terminals.

¹³⁴ QR submission, pp.38-39

¹³⁵ Indec submission, p.16

¹³⁶ Bugler, P, Advice to NR, p.9-10

*terminals, as distinct from permanent way infrastructure, do not exhibit natural monopoly characteristics and can be provided by several operators.*¹³⁷

The Council considers on the evidence provided that terminals and lifting equipment are economic for a third party to duplicate. The Council notes in relation to Carpentaria's argument that while it may be highly desirable to allow joint use of terminal facilities wherever possible, that does not mean they are not economically possible to duplicate.

Other factors, eg safety accreditation, which make the service uneconomic to duplicate

Carpentaria's submission argued that while safety accreditation could be obtained, it represents an additional long run cost penalty and hence a barrier to entry to a new entrant. Carpentaria make the following case that safety accreditation would result in the service being uneconomic to duplicate:

*In addition, one must consider the regulatory costs component of obtaining accreditation as a railway manager or railway operator. This is a significant fixed component to the regulatory costs. Given the relatively small size of an entrant's operation compared to the incumbent, these costs are relatively much higher for the entrant. They constitute a long-term cost penalty on new entrants compared with the existing operator. Thus while it may be possible to obtain accreditation in Queensland, the cost of doing so adds to the weight of evidence that the service is not economic to duplicate.*¹³⁸

QR did not accept that Carpentaria could not secure accreditation as a railway operator and that this is uneconomic to duplicate. QR and Indec argued that the number of private operators who have sought or are in the process of becoming accredited in Queensland demonstrates that the accreditation requirement would not be unduly onerous for Carpentaria.¹³⁹

Purcell argued it is impractical and uneconomic for Carpentaria to obtain and maintain accreditation for the scope of the service. Carpentaria's service frequency is not sufficient to amortise the administration cost and supervision of safety over the long distances required. Inputs such as accrediting driver competency in train handling and safe working rules over long distances would exceed a small operators capacity. Purcell noted that both SCT and TNT have limited accreditation only, with most aspects of the service provided by major railways.

In reply, Indec argued Purcell's advice is misleading in that limited accreditation including driver competency, train control etc are already provided under contract in existing track access agreements such as the NSW regime. Also small operators such as Westcoast Rail have procured their own rolling stock and obtained accreditation for that rollingstock.¹⁴⁰

QR further provided that:

The development of accreditation cases and safety management systems will be simpler and less costly for a new operator compared to an established operator with more entrenched practices. Safety should be seen as a necessary part of any transport business and not an

¹³⁷ *ibid*, p.12

¹³⁸ Carpentaria submission, pp.25-26

¹³⁹ QR supplementary submission, p.4, pp.41-42, Indec submission, p.11

¹⁴⁰ Indec "Comments on Attachment 2 of the Additional Submission from Carpentaria", p.2

*administrative burden. A good safety management system will lead to economic benefits over time.*¹⁴¹

Conclusion

As noted under criterion (d), the Council has examined the requirements of Queensland's safety accreditation regime and has not found any evidence that it is more onerous in its requirements than those operating in other states.

The Council believes there is adequate scope to contract aspects of these services, or to seek to obtain some form of limited accreditation. It does not accept the argument that the facilities are uneconomical to duplicate on the basis of the costs associated with the Queensland safety accreditation regime.

What is the capacity of QR's existing facilities to provide the Service?

There was some debate in the submissions¹⁴² about whether QR's rolling stock and terminals currently have sufficient capacity to accommodate access by Carpentaria. This is not, however, an issue for the consideration of whether to declare the service the subject of this application. Whether there is sufficient capacity to allow access is addressed through negotiation and arbitration. The arbitrator has the power to require the infrastructure owner to extend capacity to accommodate access if that is warranted. This extension however, must be paid for by the access seeker.¹⁴³

¹⁴¹ *ibid*, p.44

¹⁴² QR, Indec, SCT, RSU, NR provided arguments on the capacity of QR's facilities to provide the service. QR argued that all of their BCZY wagons are fully utilised, and that compliance with Carpentaria's application would require QR to commission the construction of an additional 200 BCZY wagons at a capital cost of \$20m. SCT contends that there is ample scope for other facilities to be developed on the Brisbane-Cairns corridor, including scope for QR to offer further trainpaths on new timetables to enable additional freight. The RSU contends that the track is presently under utilised. Indec considered much of QR's rolling stock to be old. Rolling stock is currently utilised and increased freight volumes are out of the question without a major upgrade. NR submits that rolling stock provided to Carpentaria is now fully utilised, and no spare capacity exists to provide additional services. The cost to Carpentaria of purchasing rolling stock, terminals and locomotives is recoverable from revenue.

¹⁴³ Section 44V of Part IIIA provides that an arbitration determination can require the provider to extend the facility. Section 44W(1)(e) prohibits the provider bearing some or all of the costs of extending the facility.

Conclusion

The Council has considered the views raised in the submissions and has concluded that there are aspects of the facility which could be economically duplicated or provided by another facility.

In particular, the Council is of the view that another facility could be developed to provide part of the service, that is, the above rail elements including rolling stock and terminals and that a range of narrow gauge rolling stock, whilst perhaps less than optimal, can be sourced as suitable for the Queensland rail system. Notwithstanding this, the Council considers that it would be uneconomical for anyone to develop another facility in respect of the “below rail” elements of the service that is, the track.

NATIONAL SIGNIFICANCE

(c) that the facility is of national significance, having regard to:

- (i) the size of the facility; or
- (ii) the importance of the facility to constitutional trade or commerce; or
- (iii) the importance of the facility to the national economy.

This criterion focuses on the importance of the facilities rather than the services as defined by the applicant. In the draft guide to Part IIIA of the TPA, the Council stated that “it is possible for nationally significant infrastructure to be situated entirely within the borders of a single State or Territory”.¹⁴⁴

In its application, Carpentaria stated that:

In the 1993-94 year QR undertook 43%(92 million tonnes) of Australia’s rail freight task.

Rail freight services are an integral part of the freight forwarding industry in Australia. Rail freight services contribute approximately 4% to gross domestic product with 0.5% being attributed to rail which is equivalent to \$2.6 billion per annum.

Revenue from QR’s freight division for the year ended 30 June 1996 was \$186 million.

The facilities used to provide the Services (that is, the track and all necessary plant and equipment):

(a) span over the whole of the State of Queensland and comprises more than 9,300 kilometres of railway track alone;

(b) are integral to the effective movement of people and goods both within Queensland and nationally;

(c) are a substantial contributor to Queensland’s domestic product and the nations gross domestic product;

(d) are integral and essential to the development of most major industries in the region and Australia generally;

(e) support an industry that employs more than 240,000 people (30,500 directly in the rail freight area);

(f) are an important component in strategic defence issues.¹⁴⁵

In Carpentaria’s supplementary submission, they identify sub-criteria (i) and (iii) to establish the facilities are of national significance.

¹⁴⁴ Draft Guide to Part IIIA, p.26

¹⁴⁵ Carpentaria application, pp.21-22

Must the Facilities be considered together or separately?

An area of substantial debate in submissions was whether the Council should determine the national significance for all the facilities defined by the application (that is, track, rolling stock, lifting and shunting equipment) or determine the national significance of each separate facility? A number of submissions singled this question out as particularly important in setting the way in which future competition in rail will be developed.

Carpentaria argued that all facilities must be considered in total. In particular, Carpentaria's submission stated that:

It is the service provided by several facilities to which access is sought. It is access to the Service provided by the aggregate of those facilities which must promote competition. Thus, consistently, the Council has stated that it would generally consider national significance to be established if:

- . such a market provides substantial annual sales revenue to businesses in it; and*
- . providing access would be likely to substantially promote competition.*

Consistent with this approach it must be the aggregate of facilities which needs to be considered.

In total the facilities which provide the Service are of national significance. If facilities are disaggregated into smaller and smaller units the significance of each individually is naturally less, but this ignores their combined significance. The process of separating facilities is an arbitrary one - would each terminal be considered in isolation or as terminal facilities.

Treating facilities separately would be likely to have perverse effects in terms of the policy intent underlying the declaration process. For instance, if as a result of considering facilities separately one facility was not judged to be of national significance it would mean that the application as a whole would not succeed, regardless of whether the services as a whole met all other criteria including that of national significance. It would not appear to be the policy intent behind the criteria to have applications for declaration succeed or fall on whether a small component of the facilities to which access is sought is not of national significance¹⁴⁶

Alternatively, QR¹⁴⁷ and NR argue that national significance needs to be determined for facilities separately. Advice provided as an attachment to NR's submission from Robert Officer, Professor of Finance, University of Melbourne, argued that the facilities should be treated separately for the purposes of declaration and subjected separately to each of the tests. In particular, he argued that:

...in order to bundle facilities together and to treat them as one requires a high degree of complementarity between the facilities such that one would be rendered useless without the other and there is no clear separation or independence of one facility from the other...However, it should be pointed out that complementarity alone is not a sufficient condition for bundling. There may be circumstances where there is an ability to separate

¹⁴⁶ Carpentaria submission, pp.29-30

¹⁴⁷ QR submission, p.48

*the complimentary goods or services and competition policy may be better served by unbundling. For example, it is common to unbundle an electricity transmission grid from the supply of energy so that power can be contracted separately and treated as a different product from the transmission even though there is clear complementarity between the two.*¹⁴⁸

Officer argued to treat facilities in total as a single facility and therefore a single test runs the risk of an unwarranted widening of the scope of essential facilities. This could have detrimental effects to the economy and more particularly investment. If a non-essential facility is declared, it will impose costs on the facility provider which may limit further investment and competition by other potential providers of the facility. The risk of unwarranted widening of the scope for mandating access are outlined in the Council's draft guide to Part IIIA.

Officer therefore contends that:

"...a prima facie case only exists for the track satisfying the tests for declaration, as set out under the Act, when considering the facilities in question...

...on the basis of prima facie evidence that locomotives and the rolling stock would fail the test on the grounds that these would not constitute a natural monopoly ...They are also likely to fail the other tests on the grounds that these can be supplied from many sources and therefore a lack of access to a particular set of locomotives and rolling stock are not likely to cause a detriment to competition nor be of national significance...

*Similarly, terminals...are unlikely to meet the tests. They may meet a natural monopoly test if a geographic market is defined fairly narrowly, which is also likely to limit the relevance of a national significance test..."*¹⁴⁹

Legal advice gained by NR from Deacon Graham & James summarises the need for balance when looking at national significance:

*The term "facility" is not to be defined so narrowly as to defeat the purpose of Part IIIA of the TPA, which is to provide for competitive access to the services provided by national infrastructure facilities. At the same time, it is not to be interpreted so broadly as to allow separate facilities and the services they provide, which do not meet the test for being regarded as essential in the TPA, to be bundled with those which do.*¹⁵⁰

Conclusion

In looking at national significance, the Council needs to balance the risk of over aggregation and therefore recommending declaration of facilities which are not nationally significant with disaggregating too far and recommending a service not be declared simply because one facility, which is integral to providing that service, is not nationally significant.

The Council considers the most appropriate way of assessing the national significance test will vary between applications and will be influenced by factors such as the extent to which each of the

¹⁴⁸ Officer R, Advice to NR, p.3

¹⁴⁹ *ibid*, p.4

¹⁵⁰ Miller R, Deacon Graham & James, Advice to NR, p.3

facilities are integral to providing the service the applicant is seeking access to. This will be determined in applying the test of section 44F(4).

As a general rule, the Council considers that there should be consistency of treatment of the criteria which specifically address the facilities providing the service: that is, criterion (b), section 44F(4), and criterion (c). Whether the facilities should be considered separately under criterion (c) will therefore depend on whether it has been concluded under section 44F(4) that the facilities can in part be economically duplicated.

For this application, in its consideration of section 44F(4), the Council concluded that rollingstock and terminals are economically feasible to duplicate and therefore are not essential to gaining effective access to Queensland rail services. Because of this, the Council has concluded that it is appropriate to consider the issue of national significance in relation to the separate facilities identified in section 44F(4) that is, the track, locomotives and rollingstock, and terminal facilities and loading equipment.

The role and importance of the Brisbane-Cairns rail corridor

The size argument

In the draft guide to Part IIIA of the TPA, the Council states that while the physical dimensions of the infrastructure may in some instances indicate that a facility is of national significance, in others it is unlikely to be conclusive.

(a) the track

In its submission, Carpentaria argued in terms of size alone, the facilities are clearly of national significance:

The track on the Brisbane-Cairns corridor is approximately 1700km long and services directly 11 ports on route, including significant centres such as Mackay, Bowen, Ingham, Cairns and Townsville. In addition, this facility enables inland ports to be serviced through onforwarding. This allows onforwarding to Mt Isa, Emerald and other destinations.

Carpentaria does not have sufficient information to enable it to separate the value of the assets involved in the provision of the Service from the total assets of Queensland Rail. QR's non-current assets have a value of \$4.9b in the 1995-96 Annual Report. Given the information set out in the Queensland rail submission, the value of the assets required to provide the service would in all likelihood approach \$1b.

If rail infrastructure of this size and value is not of national significance, then the reach of Part IIIA will be extremely limited.¹⁵¹

Carpentaria and QR agree that the nominated track covers some 1,700 kilometres. However, QR and Indec argue this represents less than 20 percent of Queensland's total track infrastructure, and less than 3 percent in a national context.¹⁵²

The BTCE Report notes that the Brisbane-Cairns corridor is one of the longest in Australia, equivalent to the Brisbane-Sydney and Sydney-Melbourne corridors combined.¹⁵³

The Council is persuaded that the track is nationally significant because of its physical size under this criterion.

(b) Rolling stock and terminals

The Council is not convinced that the specified rolling stock could be considered to be nationally significant on the basis of its size.

Similarly, the Council does not believe the terminal facilities specified could be considered to be of national significance due to size. The terminal facilities defined are regional terminals that service the requirements of Northern Queensland and are unlikely to be large when compared to other terminals in the capital cities for example.

The volume of trade argument

In the draft guide to Part IIIA of the TPA, the Council defines constitutional trade or commerce as trade or commerce between States or Territories or international trade or commerce. The Council will consider the monetary value of trade, as well as the importance of the service to trade in related markets. For example, services provided by intrastate rail infrastructure may be nationally significant because it is essential to promote competition in another market, possibly an export market.

Carpentaria did not seek to establish national significance under this criteria.

(a) the track

Submissions arguing against national significance under this criteria came from QR, Indec, NR, the RSU and Westrail.

QR did not accept the volume or value of trade on the North Coast Line is of national significance as a proportion of Australian interstate and export trade or as a proportion of the nation's gross domestic product. In terms of general freight carried, Carpentaria's service accounts for less than 1 million tonnes annually or less than 1 percent of all freight carried by QR. QR and Indec argue that the standard gauge rail network would be nationally significant in terms of tonnage carried and strategically as the networks connects all State capitals and ports.¹⁵⁴

¹⁵¹ Carpentaria submission, pp.30-31

¹⁵² QR submission, p.46, Indec submission, p.18

¹⁵³ BTCE Working paper 14.2, "Adequacy of transport infrastructure: Rail", p.20

¹⁵⁴ QR submission, pp.46-47, Indec submission, p.18

NR argued “the size of the flows of goods on the line-haul train services and using the terminal facilities, and therefore the likely magnitude of the benefits flowing from a declaration, are not sufficient to make these facilities nationally significant.”¹⁵⁵

The RSU, while conceding the track network throughout Queensland to be nationally significant, consider it is difficult to establish the nominated trainpaths are nationally significant in terms of general freight hauled by QR compared with road transport.¹⁵⁶

Westrail felt that given the facilities were confined to intrastate trade in Queensland, it is doubtful the value of this trade is great enough to be regarded as significant from a national perspective.¹⁵⁷

The Council is not convinced that the track could be considered to be nationally significant on the basis of the volume of trade in general freight conducted on the rail corridor. It therefore follows that the rolling stock and terminals are not considered to be nationally significant on the basis of volume of trade in general freight.

Importance to the National Economy Argument

In the draft guide to Part IIIA of the TPA, the Council states that in assessing the importance of an infrastructure service to the national economy, the Council will particularly examine the market in which access would promote competition, and that the Council would generally consider national significance to be established if such a market provides substantial annual sales revenue to businesses in it, and access would be likely to substantially promote competition.

In its submission, Carpentaria argued the facility is nationally significant because of its effect upon the national economy and Queensland economy. Carpentaria provided the following:

In further amplification of the matters raised on p21 of the Application Carpentaria draws to the Council’s attention the significance of the facility in the following respects:

(a) all refined white sugar manufactured by Mackay Refined Sugar for delivery to Brisbane is moved along this rail corridor;

(b) approximately 100,000 tonnes of refined copper is moved from the refinery at Townsville to Brisbane and onforwarded to other states in Australia: a significant volume of which moves by rail on this corridor;

(c) a significant proportion of consumables and other supplies used in the tourist destinations of Queensland are either supplied directly or with onforwarding from the rail infrastructure on this corridor;

(d) nearly all food manufactured interstate and transported.¹⁵⁸

(a) the track

¹⁵⁵ NR submission, p.8

¹⁵⁶ RSU submission, p.13

¹⁵⁷ Westrail submission, p.4

¹⁵⁸ Carpentaria submission, p.31

NR believes “the track infrastructure can be considered to have at least the potential to be of national significance, owing to the destinations served...”¹⁵⁹

Placer Pacific uses Carpentaria’s services through Townsville as the consolidation point for road, rail and shipping requirements to and from minesites in Queensland and off shore.¹⁶⁰ Mackay refined sugar uses Carpentaria’s service to move refined sugar from Mackay to Brisbane for distribution in the Queensland market and for export through the port of Brisbane.¹⁶¹

Berg Shipping Consultancy argued national significance in terms of mining opportunities along the coast, possible industry development following the opening of the Papua New Guinea - Queensland gas pipeline to Townsville and possibly Gladstone.¹⁶²

The Council considers the track to be nationally significant in terms of its importance to the national economy due to the importance of the ports serviced. Also, the Brisbane-Cairns corridor is the main trunk line which is essential to the efficient operation of all of Queensland’s rail system. Therefore, it is critical in providing rail transport services to all of the major centres in Queensland.

(b) Rolling stock and terminals

The RSU contends that the small number of facilities other than track to provide the service cannot be seen as important to the national economy as they can be copied or supplied from other sources.¹⁶³

These facilities provide only a small part of the rail transport task in Queensland, less than 1 percent of all freight carried by QR,¹⁶⁴ therefore their significance is much less than that of the track.

The Council acknowledges the issue identified by Carpentaria of how far facilities should be disaggregated given the national significance of increasingly smaller units will naturally be less. For example, should each terminal be considered in isolation, or should terminal facilities be considered together? This requires a judgement on how far facilities should be disaggregated.

In assessing this criteria, the Council will again adopt an approach consistent to that used for section 44F(4), that is, it will consider commercial groupings of facilities. In the case of this application, the Council has concluded that as a group, these facilities are not nationally significant, and hence it has not disaggregated the facilities further.

In relation to the issue of small facilities, the Council considers these can be nationally significant depending on their importance to the national economy. However, the Council does not believe that this is the case for this application. The specialised rolling stock and terminals, while important to the geographical region they serve, are not nationally significant.

Conclusion

¹⁵⁹ NR submission, p.8

¹⁶⁰ Placer Pacific submission

¹⁶¹ Mackay Refined Sugars submission

¹⁶² Berg Shipping Consultancy submission, p.3

¹⁶³ RSU submission, p.13

¹⁶⁴ QR submission, p.47

The Council concludes that Carpentaria's application fails to meet this criteria.

In relation to the track, the Council finds the arguments presented in favour of national significance persuasive in relation to the Brisbane-Cairns rail corridor having regard, in particular, to criteria (i) and (iii). Thus, the Council is of the view that the track is of national significance due to its physical size, the importance of the ports served and the operation of the corridor as the main trunk line of Queensland's rail system providing rail transport services to the major centres in Queensland.

The Council does not consider the rolling stock specified and the terminals nominated by the applicant to be nationally significant.

HUMAN HEALTH AND SAFETY

(d) that access to the service can be provided without undue risk to human health or safety

In the draft guide, the Council stated that “access should only be impeded by *bona fide* safety considerations”. Applicants must provide a description of how access can be provided without compromising system integrity or safe scheduling or posing undue risk to human health or safety. Infrastructure operators who seek to deny access on safety grounds must bear the onus in demonstrating to the Council that access to the service would compromise safety.

Carpentaria is seeking access to the service as it is presently provided by QR and therefore contends that there are no undue risks to human health and safety. In its application, Carpentaria stated:

There is sufficient spare capacity to provide a safe Service without undue risk to human health or safety. In fact, a much lower safety risk will result if the Services are provided by QR rather than by another operator who must share facilities with QR. This is because QR will remain in control and will therefore have an unambiguous responsibility to ensure that safety risks are minimised, consistent with its obligations under the Workplace Health & Safety Act.¹⁶⁵

QR did not contend that there are any health and safety risks in access being provided as requested provided that requirements for matters such as dangerous goods and out of gauge loadings are complied with.

The Council has examined the requirements of the Queensland safety accreditation regime. The provisions of that regime are described in information obtained by the Council from the Queensland Government as “very similar to those of other State jurisdictions”, with some minor differences. The Queensland government provide the following examples:

- The Queensland legislation does not require the accreditation of persons who maintain or build rolling stock. This is required in NSW legislation, whereas in Queensland it is only the person operating the rolling stock on a railway which needs to be accredited.

The Victorian legislation goes further than the NSW legislation and requires both the providers and operators of rolling stock to be accredited.

- In Victoria, anyone who causes another person to operate rolling stock on a railway is also required to be accredited. A similar requirement in Queensland is likely to cause any company which has train loads of freight moved by Queensland rail to seek accreditation as they would be deemed to have caused Queensland Rail to operate that train. As a result, organisations such as TNT, Hiles, GrainCo and cattle and sugar industry operators may need to seek accreditation. As in the previous comparison, the Queensland accreditation regime provides that if an accredited operator is required to take responsibility for operating rolling stock on a railway, then only that company is required to be accredited.

FreightCorp stated that Queensland’s safety standards are not excessive in comparison with NSW where more than 20 private operators are accredited. FreightCorp does not consider there are any impediments to suitably accredited operators gaining access to below rail infrastructure for reasons of safety. Also it did not accept Carpentaria’s argument that access to the service provided by QR

¹⁶⁵ Carpentaria application, p.22

as it is presently conducted would enhance safety compared to a service operated by a third party as any accredited operator would have identical safety obligations under the legislated requirements for accreditation.¹⁶⁶

In other submissions, potential safety issues identified from open access included:

- *an increase in risk to the safety of employees working in terminals if opened to competing users*

NR identified a potential safety hazard created by daily competition for spare capacity within terminals (which cannot be readily separated within confined terminal space) and for use of the limited numbers of loading devices by multiple users in freight terminals. Shunting of trains operated by competing rail operators within confined terminal space would also increase the risk of accidents affecting employees carrying out shunting, train inspection and other terminal tasks.¹⁶⁷

- *Movement of Dangerous Goods*

The RSU contended that Carpentaria has not addressed the real issue of access requiring Carpentaria to meet all safety issues to the same standard as QR. Carpentaria is seeking access to the service regardless of the freight carried and expects QR to meet all safety risks to the membership of the RSU, in particular the movement of dangerous goods. The RSU argued that Carpentaria must be accredited as a rail operator and meet all Australian standards in freight forwarding.¹⁶⁸

Conclusion

The Council recognises that there is a need for rail operators to meet legitimate safety standards, particularly in relation to the transport of dangerous goods. This issue, however, has been successfully addressed elsewhere in Australia and overseas. Therefore, after considering the arguments presented the Council is satisfied that access to the service can be provided without undue risk to human health or safety.

¹⁶⁶ FreightCorp submission, p.7

¹⁶⁷ *ibid*, p.6

¹⁶⁸ RSU submission, pp.13-14

EFFECTIVE ACCESS REGIME

(e) that access to the service is not already the subject of an effective access regime

Section 44G(2)(e) provides that the Council cannot recommend a service be declared which is already the subject of an effective access regime. In taking into account whether an access regime is effective, the Council must only consider the matters set out in clause 6 of the Competition Principles Agreement.

Conclusion

All of the submissions identify that the service is not presently the subject of an effective regime.

A number of submissions raised arguments on the imminent introduction of a state access regime. These arguments are addressed under the public interest criterion.

Legislation was passed by the Queensland parliament in May, establishing a state based access regime to take effect from the date of proclamation. It is expected that this regime will cover the rail line from Brisbane to Cairns.

The establishment of the regime has occurred late in the Council's consideration of this application.

As declaration is not recommended in relation to the other criteria, the Council has not fully considered the regime. A full examination of the regime would necessarily be carried out in the context of future applications. It is the Council's understanding that the access regime in Queensland is yet to cover rail services for which access is sought for the purposes of section 44G(2)(e).

PUBLIC INTEREST

(f) that access (or increased access) to the service would not be contrary to the public interest

In the draft guide to Part IIIA of the TPA, the Council notes that this criteria is expressed in the negative rather than the positive. This reflects the fact that criteria (a) to (e) already address a number of positive elements in the public interest. The Council has stated that if declaration were judged to be neutral in public interest terms, the Council would recommend declaration if criteria (a) to (e) were satisfied.

The Council has considered the various public interest arguments for declaration of the service as outlined in submissions. Since the application does not satisfy criteria (a) to (e), the Council provides this discussion for information only.

In its application, Carpentaria provide that:

Carpentaria considers that access to the Service would not be contrary to the public interest and that tangible benefits to the community, will include:

- (a) effective competitive freight forwarding services connecting to an Australia-wide network and serving Queensland generally, in particular Far North Queensland;*
- (b) the economic development of Australian infrastructure, fostering business efficiency, enhancing world best practice and enabling QR to achieve, national competitiveness for the benefit of organisation's moving freight by rail and consumers and the economy generally;*
- (c) the protection of the environment by keeping Carpentaria's customers goods off national highways and on the rail network;*
- (d) more efficient use of under-utilised assets that currently exhibit spare capacity;*
- (e) expansion of employment opportunities in an efficient rail freight forwarding market; and*
- (f) promotion of equitable, non-discriminatory pricing in the rail freight forwarding market¹⁶⁹*

Major public interest issues raised against declaration were:

- the proposed introduction of a state access regime;
- national developments including consistency across access regimes, and asset realisations;
- extension of access to “above rail” and “ancillary services”;
- economic efficiency;
- industrial relations, employment and regional development;

¹⁶⁹ Carpentaria Application, pp.22-23

- historical factors and recent negotiations; and
- recent inquiries.

These issues will be considered in turn.

State Access Regime

As noted under criterion (e), the Queensland Government has passed legislation establishing a state based access regime which, among other things, would cover QR. The regime includes a declaration process and access codes which tailor the generic regime to specific classes of infrastructure. The proposed Queensland Competition Authority (QCA), as an independent authority, will have a number of roles including assessment of whether services provided by infrastructure should be subject to the regime, accepting undertakings from infrastructure owners, and acting as a dispute resolution body.

In relation to rail services, the proposed regime will probably declare track on the Brisbane-Cairns and Townsville-Mt Isa lines, with the potential for the remaining services (including rolling stock) to be considered on the basis of a threshold test.

The legislation was passed by parliament in May. The regime will take effect from the date of proclamation. It is Queensland's intention to seek to have the regime certified by the Council as "effective".

There is an issue as to how to treat this declaration application in the light of the impending Queensland regime, and whether the regime should impact on the Council's consideration of the Carpentaria application for declaration.

A number of submissions (QR, FreightCorp and PTU) argued it would be inappropriate to declare the service pending the imminent introduction of the regime. The PTU states that it is unnecessary and potentially disruptive for the Council to make a decision on this application given the regime is so far advanced. There has been no indication that the Queensland access regime would not qualify as 'effective', such that a decision on this application could be considered to be 'tantamount to an over-ruling of Queensland's regime before it has been properly judged'.¹⁷⁰ QR and Indec further requested the Council defer its decision in the public interest until draft legislation and details of the regime become available.¹⁷¹

The Council is statutorily required under section 44F(2) to act on receiving an application that meets the requirements of Trade Practices Regulation 6A and to make a recommendation to the designated Minister that the service be declared or not declared. The Council has no power to defer consideration of a valid application.

Also, arguments that the Council should have no regard to the proposed state regime were raised in a number of submissions. In particular, it was suggested that because the proposed regime is draft legislation only which may not be passed, and could be subject to changes and delays, there was no guarantee of when an effective regime would be introduced.

¹⁷⁰ PTU submission, pp. 2-4

¹⁷¹ Indec submission, p.20; QR submission, p.50

The NSW Minerals Council Ltd argued that while it may be “procedurally inefficient” to recommend declaration of a service that might be covered by a state regime, the Council should still declare. The submission argued there is no certainty that the legislation would result in a regime which would cover Carpentaria’s service, no undertaking with the ACCC exists in relation to the regime, and it may be in QR’s interest for resolution of the issue to be deferred as long as possible. The regime appears to require additional access codes and thus it could be years before a regime for the service sought by Carpentaria is developed, and there is no certainty that it would be effective.¹⁷²

Carpentaria’s submission acknowledges that the imminent introduction of a state access regime is a relevant factor for the Council to consider under the public interest. However, Carpentaria stated that “it is virtually impossible to speculate whether the regime if implemented may, at some point in the future come to be an effective regime.”¹⁷³ Carpentaria argued that the regime cannot be considered to be “imminent” given the uncertainties as to the nature, timing and scope of the regime, and whether any regime if established would satisfy the criteria of being effective. This means that “it is simply too uncertain to take into account in the present case.”¹⁷⁴ Further advice to Carpentaria from David Bennett QC stated:

*State legislation for an access regime similar to that contained in Part IIIA of the Act is likely to be considered by the Queensland Parliament in May 1997. In the event that the legislation is passed, it is likely to be some time before application can be made and some more time before that application can be determined...*¹⁷⁵

*It is clear in the present case there is no effective access regime in Queensland. Before such a regime can exist, the Queensland legislation must be passed, the administrative aspects of the regime established, an application made by the Premier to the Council asking it to recommend that the Minister (Commonwealth Treasurer) decide that the regime is an effective access regime and a decision to that effect by the Minister. All this will take time and no step in the process may be regarded as certain.*¹⁷⁶

QR’s supplementary submission argued that Bennett “unduly dismisses the relevance and weight of the initiatives of the State Government to establish a Queensland Competition Authority consistent with the Competition Principles Agreement”,¹⁷⁷ and that the Council could examine the legislation and make a decision on the effectiveness of the regime under section 44G(2)(e). In particular:

...In QR’s view, it is open for the Council to determine under Section 44G(2)(e) whether the access regime adopted by the Queensland Government is an effective access regime for the purposes of the Part IIIA application...The Council would be entitled to examine the statutory instruments and decide whether the access regime is, in its view, “effective” having regard to the relevant principles set out in the Competition Principles Agreement...Accordingly, the Council can examine the legislation and form its own view without any of the other protocols Mr Bennett speaks of, occurring. If the Council is satisfied that the access regime relevantly reflects the elements of the CPA it would no doubt take the view that Section 44G(2)(e) is made out with the result that no declaration

¹⁷² NSW Minerals Council submission, pp.1-2

¹⁷³ Carpentaria submission, p.31

¹⁷⁴ loc cit

¹⁷⁵ Bennett, DMJ QC, Opinion, p.1

¹⁷⁶ ibid, p.2

¹⁷⁷ QR supplementary submission, p.48

recommendation would be made...To ignore it or find it almost impossible to give any weight to these new arrangements would be absurd...

...it would be contrary to the public interest to largely ignore the intervention of such legislation and the due process that has led to it and simply grant access under Part IIIA. Plainly, no access declaration should be made in the current circumstances.

No dislocation or disadvantage flows to Carpentaria by refusing a declaration on this ground pending the commencement date for the Queensland legislation as Carpentaria already is provided with the relevant service.¹⁷⁸

The Council recognises the Queensland Government is investing considerable time and resources in seeking to establish a state based access regime. However, the Council cannot make a considered assessment of the effectiveness of the Queensland Regime until the regime is in place and without a full public process. For instance, at this stage, it cannot be certain about the nature of any access codes which may be introduced for rail under the regime and it appears that all the elements in the service in this application will not be covered by the regime.

The Council believes that a decision on this declaration application does not affect the introduction of the state based regime. Even if the service was to be covered in the future by an effective regime, the Council could still recommend declaration to provide access to the applicant and other third parties at the earliest possible time. This would not result in declaration over-ruling the state regime because the introduction of an “effective” regime would mean that the conditions for declaration are no longer met and the Council could at that time consider revoking the existing declaration under section 44J.

National Developments

BHP Transport requested the Council give due regard to the broader implications of a decision to declare on other rail services in Australia including the proposed national government owned track entity to manage and provide interstate rail network access. All States and the Federal Government are moving towards their own rail access regimes and at the very least there must be uniform application of accepted principles of access.¹⁷⁹

Indec argued that the possibility of a successful declaration could disrupt Commonwealth reforms to unify and rationalise national rail. Indec believes that conditional access to track infrastructure should be granted. However, given the absence of a national track authority, access should be granted by the various States to ensure that increased competition does not marginalise the state systems. Further, declaration could erode the proceeds from national sales such as AN as interests wish to purchase assets as ongoing concerns. The risk of a successful declaration means investors are less likely to invest.¹⁸⁰

The PTU identified a potential for pricing anomalies and interstate inconsistencies to result from access under different regimes. The PTU pointed to the SCT application presently before the Council which seeks declaration for a period of twenty years, compared with Carpentaria seeking

¹⁷⁸ QR submission, p.48

¹⁷⁹ BHP submission, p.2

¹⁸⁰ Indec submission, p.21

declaration for 7 years. The PTU argues that the variations between the applications mean that if each were granted, there would be a great deal of inconsistency in application of rail access.¹⁸¹

The Council acknowledges there is a potential for access regulation to diminish incentives for businesses to invest in infrastructure facilities and thus limit, rather than enhance, overall competition and economic efficiency. These are reasons why the criteria for declaration were designed to ensure that they would lead to declaration being applied to large, nationally significant pieces of infrastructure, so that the potential benefits were strong and would outweigh the costs.

Also, the national access regime under Part IIIA of the TPA presently applies to all rail operators who are equally open to declaration as QR is. By examining the merits to declare or not to declare, the Council is seeking to better define those situations where declaration will be relevant.

In relation to PTU's argument concerning the SCT application for declaration of NSW rail services, the Council makes a number of points. First, it is yet to make a decision on the SCT application including the requested length of the declaration period. Second, the services which are the subject of the two applications differ in terms of scope and definition such that there may be legitimate reasons for the declaration period requested in each case. Third, when the period of declaration expires, the existing terms and conditions do not automatically revert to those that existed prior to declaration. It is open for anyone to reapply for an extension to the declaration period.

The Council sees no more uncertainty resulting from a decision to declare the subject application than presently exists. In fact, publishing the Council's views on what aspects of rail services do and don't meet the criteria for declaration, and even the introduction of access regimes in some areas, will increase certainty by raising the level of information available on what services could be declared and how access would work in practice. The Council therefore concludes that this consideration should not prevent recommendation of the service as sought by Carpentaria.

Extension of access to Above rail and Ancillary Services

FreightCorp argued the application refers to a composite service which includes elements of non-essential infrastructure. Declaration would lead to an expansion of the principles of open access which could lead to business being unable to invest in assets with any confidence as to the control over usage. Competition would be restricted in total rail services in which businesses can achieve competitive advantages as introduced efficiencies would be less than that provided by access to below rail infrastructure only.¹⁸²

SCT argued that rail competition can and does take place on the basis of access to the track only, and there is no necessity to include rolling stock, lifting and shunting equipment. The basis of SCT's business in competing with NR is the selection of different rolling stock.¹⁸³

QR argued the Council needs to weigh carefully granting access over a set of facilities and services which would broaden the scope of an access regime well beyond established economic thinking on the functions of an access regime, impose significant costs on QR, present a disincentive to

¹⁸¹ PTU submission, pp.18-19

¹⁸² FreightCorp submission, pp.4-5

¹⁸³ SCT submission, p.4

investment of capital in new facilities and infrastructure, cast doubt on QR's ability to secure future returns, and further entrench Carpentaria's market power in the market.¹⁸⁴

The PTU argued the inclusion of above rail and ancillary services go beyond what could be considered as reasonable access.¹⁸⁵

The Council has considered and addressed these arguments under criteria (a), (b), (c) and 44F(4). These criteria are designed to ensure that only those facilities the regime was intended to cover meet the conditions of declaration.

Economic Efficiency

The ARA argued that declaring the service to which Carpentaria seeks access would not be "economically efficient" because sufficient competition already exists in provision of the service to ensure that technical, allocative and dynamic efficiency are provided.¹⁸⁶

This issue is addressed in the discussion of criterion (a) where it was concluded that competition would be generated in another market.

Industrial relations, Employment and Regional Development

QR has existing industrial relations policies in place. If different policies were used by a new entrant, occupational health and safety and industrial relations issues could emerge in such areas as award and union coverage, award conditions, occupational health & safety compliance by new entrants using QR's network, uniformity of enterprise bargaining, and access of personnel to QR sites, and Carpentaria using its own employees for limited aspects of the service.

The Council believes the Queensland Government safety accreditation scheme covers the issues raised in relation to occupational health and safety concerns. The industrial relations issues identified are part of normal commercial considerations which apply across all industries, and are not rail specific. No specific examples of "different policies" to be used by Carpentaria were cited.

The PTU identified employment effects, social welfare and regional development as public interest factors to be considered. The PTU notes the employment effects from access are "difficult to gauge" since Carpentaria will continue to use QR's services. However, reduced QR revenues will further pressure employment numbers with likely job losses concentrated in regional Queensland. The RSU states that QR is already involved in substantive reform. Access may require a faster program of reform by QR resulting in job losses throughout Queensland. The PTU claims that a disruption of QR's program would hinder its ability to maintain and upgrade infrastructure.¹⁸⁷

The ARA submitted that there are significant social considerations in terms of the effect on QR's business with its consequent effect on regional employment and the impact any job losses would have on rural communities.¹⁸⁸

Carpentaria has applied for access as a means to expand rather than contract its operations. A decision to declare could also result in other competitors further utilising the rail line which could

¹⁸⁴ QR submission, pp.3-5

¹⁸⁵ PTU submission, p.10

¹⁸⁶ ARA submission, p.2

¹⁸⁷ PTU submission, p.22

¹⁸⁸ ARA submission, p.2

result in an increase in rail transport. Furthermore, there are potential benefits to regional Queensland of a more efficient transport system to service the needs of North Queensland. It is difficult to accurately gauge the extent to which changes would occur.

The public interest includes the interests of rail workers, the interests of regional businesses, consumers and new rail operators and their employees. Because access is likely to generate benefits to many groups and there is doubt whether it will impose any significant costs on rail workers, the Council feels there is insufficient evidence to conclude that declaration would be contrary to the public interest in terms of these issues.

Historical factors

QR argued that there are public interest reasons for not making a declaration recommendation based on historical arrangements and the recent history of negotiations between QR and Carpentaria. In particular, QR has historically provided and continues to provide access to the linehaul services to Carpentaria, and the Council should await the outcome of future negotiations between the parties.¹⁸⁹

The Council has substantively addressed this argument under criteria (a). The Council recognises the historical position underpinning the operations of QR and Carpentaria. The benefits of declaration in this case would be to open the potential for new opportunities from competition in terms of efficiency and potential new entrants.

Recent Inquiries

The Council in its issues paper asked if it should take into account the recommendations of the 1995 BIE Rail Freight International Benchmarking Study, and the Queensland Commission of Audit on rail Services under the criteria of the public interest.

A number of submissions argued it would be inappropriate to consider these inquiries. For example, QR¹⁹⁰ and Indec¹⁹¹ argued:

- the BIE study is now out of date given reform progress made by QR since the data was gathered (1994/95 financial year);
- Neither the BIE study nor the Audit Report specifically quantify performance gaps or comment on the specified Carpentaria service separate from other QR activities;
- the Queensland Government has yet to formulate and publish a response to the Audit Report; and
- the only evidence useful to the Council's deliberations would be a comprehensive benchmarking study incorporating specific performance gaps of the service specified in the Carpentaria application.

The NSW Mineral's Council argued the Council should take into account the BIE study and the Audit Report in so far as it assist the Council's deliberations for or against declaration in terms of whether the proposed *regime* complies with the CPA principles. The submission stated:

¹⁸⁹ QR submission, pp.51-54

¹⁹⁰ *ibid*, p.55

¹⁹¹ Indec submission, pp.22-23

The task of the Council is a limited one - to recommend for or against declaration. In doing so it must determine whether or not any regime is effective under the terms of the CPA. The Council's ability to encourage adoption of the (BIE) study's recommendations is therefore limited to indicating in its reasons for recommending in favour or against declaration, where the existing regime (if any) falls short of or complies with the principles in the CPA.¹⁹²

Similarly, the Council should take into account the recommendations of the Queensland Commission of Audit on rail services, where these are consistent with implementation of the CPA.¹⁹³

The submission then discussed the effectiveness criteria and issues of structural separation, promoting competitive neutrality, pricing principles and prices oversight under the CPA.

The Council has discussed the issue of an effective access regime under criterion (e).

Conclusion

The Council has examined the public interest arguments presented and is satisfied that access to the service would not be contrary to the public interest.

¹⁹² NSW Mineral's Council, p.3

¹⁹³ *ibid*, p.5

4. CONCLUSION

The Council has considered the application made by Carpentaria Transport Pty Ltd against each of the criteria in sections 44F(4) and 44G(2). It is the Council's view that the application fails to meet the criteria.

The Council recommends that the Queensland Premier **not declare** the service the subject of Carpentaria's application on the basis the application has failed to meet the criteria of sections 44F(4) and 44G(2)(c).