

# Submission Accompanying and Explaining the Draft Queensland Rail Access Undertaking 1 – (March 2012)

 QueenslandRail





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**Attachment 1: PWC Supporting Analysis – Treatment of Passenger Services**

**Attachment 2: PWC Supporting Analysis – Ringfencing Arrangements**

**Attachment 3: PWC Supporting Analysis – Capacity Allocation**

**Attachment 4: PWC Supporting Analysis – Pricing Principles**

## Glossary

ACCC	Australian Competition and Consumer Commission
ARTC	Australian Rail Track Corporation
AU1	Queensland Rail’s “Draft Queensland Rail Access Undertaking 1” as given to the QCA with this document.
DBCT	Dalrymple Bay Coal Terminal
DTMR	Queensland Department of Transport and Main Roads
DTP	Daily Train Plan
MTM	Metro Trains Melbourne
MTP	Master Train Plan
NMP	Network Management Principles (as set out in AU1)
PWC	PricewaterhouseCoopers
QCA	Queensland Competition Authority
QCA Act	<i>Queensland Competition Authority Act 1997 (Qld)</i>
QR National	QR National Limited
QR Network	QR Network Pty Ltd (a subsidiary of QR National)
Queensland Rail	Queensland Rail Limited
Rail Safety Act	<i>Transport (Rail Safety) Act 2010 (Qld)</i>
Standard Access Agreement	The Standard Access Agreement for coal carrying train services as set out in Schedule D of AU1.
Temporary Undertaking	QR Network’s 2008 Access Undertaking (as at 30 June 2010) to the extent that it was made to apply to Queensland Rail by a transfer notice and project direction dated 29 June 2010 under the <i>Infrastructure Investment (Asset Restructuring and Disposal) Act 2009 (Qld)</i> from 30 June 2010.
TI Act	<i>Transport Infrastructure Act 1994 (Qld)</i>



## Executive Summary

This document is in support of AU1 which has been given to the QCA as a voluntary draft access undertaking under section 136(1) of the QCA Act. AU1 is Queensland Rail's first draft access undertaking in relation to the declared service under the QCA Act for which Queensland Rail is the owner and operator.

Background information has been included in this submission in relation to various matters relevant to the formulation of AU1 to seek a shared understanding with stakeholders of important principles. Queensland Rail has, for example, included additional background information in relation to the declared service, passenger priority legislation (section 265 of the TI Act) and train path preservation legislation (section 266A of the TI Act).

The matters addressed in this document provide an outline of key issues relevant to AU1, and clarify questions raised by customers and stakeholders during Queensland Rail's consultation process. This document is not intended to provide commentary on all aspects of AU1.

### The Queensland Rail Business

Queensland Rail operates passenger train services and provides access to its rail network to other rail haulage operators. Queensland Rail receives transport service payments from the Queensland Government for the operation of its passenger train services. All of Queensland Rail's passenger train services use either preserved train paths under section 266A of the TI Act or train paths necessary to satisfy the Director General of DTMR's passenger service requirements under section 266 of the TI Act.

While a vertically integrated business, Queensland Rail does not operate freight train services and its passenger train services are not in competition with third party train services. Third party operators are not expected to seek to operate passenger train services in competition with Queensland Rail during the regulatory period for AU1. As such, Queensland Rail should effectively be treated as if it were a non-vertically integrated access provider in respect of access to its rail network.

### Term of Undertaking

AU1 should have a term of at least four years but no more than five years commencing on the approval date. This term is consistent with relevant Australian rail regulatory precedent. There is a low risk of circumstances changing sufficiently during the proposed term to render AU1 irrelevant or inappropriate.

Material issues regarding costs to, and lack of certainty for, Queensland Rail and stakeholders may arise from having a term that is shorter or longer than the proposed term.

### Treatment of passenger train services

While a vertically integrated business, Queensland Rail's above rail activities in operating passenger train services are not in competition with third party train services.

Train paths for regularly scheduled Queensland Rail passenger services are allocated to Queensland Rail through sections 266 and 266A of the TI Act by the Director General of DTMR. As capacity is allocated to regularly scheduled Queensland Rail passenger services through the provisions of the TI Act, the requirements in AU1 for capacity allocation (i.e. the access application process) do not apply to Queensland Rail.

Requirements for internal access agreements are not included in AU1 as Queensland Rail's regularly scheduled passenger services do not compete with third party operators and Queensland Rail is not realistically likely to compete with third party operators during the proposed term of AU1.

## **Scope of access under AU1**

AU1 applies to almost all of the declared service. However, it does not apply to providing access for a freight train services to those parts of the rail network provided for the benefit of passengers or passenger train services. It is unlikely that freight train service will require such access.

This approach is consistent with past QCA approved rail access undertakings.

Extending AU1 to these services will create unnecessary complexity in AU1. Such access is more efficiently addressed during the term of AU1 on a case by case basis through Queensland Rail's negotiations with an access seeker, or, if necessary, by an access determination of the QCA, in accordance with the QCA Act.

## **Extensions**

AU1 includes provisions regarding the construction and funding of extensions that protect Queensland Rail's legitimate business interests, provide certainty as to when Queensland Rail will commit to construct extensions and preserve the ability to achieve negotiated outcomes for extensions.

Complex provisions relating to extensions are not warranted in Queensland Rail's circumstances.

## **Ringfencing and commercial-in-confidence**

Ringfencing requirements are only relevant for a vertically integrated monopoly that is competing with third party operations in downstream competitive markets. While Queensland Rail is vertically integrated, it does not compete with third party operators of train services.

Ringfencing provisions are not appropriate for Queensland Rail's business. However, AU1 does set out confidentiality provisions to protect the confidential information of access seekers and access holders, and Queensland Rail will maintain separate accounting records in accordance with section 163 of the QCA Act.

## **Transfer, relinquishment and resumption**

Queensland Rail has an incentive to maintain the efficient allocation of capacity in order to facilitate a commercially robust rail network. As such, AU1 includes appropriate transfer, relinquishment and resumption provisions.

## **Queuing of access applications**

Queuing is appropriate where a vertically integrated monopoly competes with third party operators. Queensland Rail does not compete with third parties for access to its rail network. As such, queuing is not appropriate for Queensland Rail's business.

Queuing would impose unnecessary administrative costs upon Queensland Rail for no clear competitive benefit. Queensland Rail's proposed capacity management framework is consistent with those put in place by other below rail providers in Australia, which allow capacity to be allocated to the access seeker which in the below rail provider's opinion, is most favourable or will best utilise the available capacity.

## **Pricing principles**

The pricing principles set out in AU1 are largely consistent with the Temporary Undertaking and overarching principles from current and past access undertakings for QR Network, QR Limited and ARTC.

## **Reference tariff reset**

AU1 retains the current reference tariff rates applying to the West Moreton System under the Temporary Undertaking (with CPI adjustments) subject to a reference tariff reset to be submitted to the QCA no later than 30 June 2013 (or such longer time as agreed with the QCA). Prior to submitting a reference tariff

reset Queensland Rail intends to consult with its customers to seek to establish an agreed reference tariff.

### **Network Management Principles and Possessions**

Various types of Possessions need to be provided for in the NMP including Planned Possessions, Urgent Possessions and Emergency Possessions. The safe running of the rail network and Queensland Rail's accreditation are dependent upon Queensland Rail being able to implement Possessions and other Operational Constraints as necessary. The NMP strike an appropriate balance between Queensland Rail's need to schedule Possessions and an access holder's interest in the operation of its train services.

### **Passenger priority legislation**

Queensland Rail is obliged to endeavour to bring delayed passenger train services back on time ahead of non-passenger train services. This is due to the requirements of section 265 of the TI Act. AU1 and the Standard Access Agreement are consistent with section 265 of the TI Act.

### **Website material**

The Temporary Undertaking includes prescriptive technical requirements due to the vertically integrated nature of the corporate group of which QR Network forms a part. As Queensland Rail does not compete with third party above rail operators, Queensland Rail has not included those prescriptive technical requirements from AU1 and will make technical requirements and information available as documents on its website.

### **Operating requirements**

The Standard Access Agreement provides that various technical matters be set out in "Operating Requirements". These "Operating Requirements" will be updatable and are intended to be applicable generally to operators on Queensland Rail's network. Queensland Rail is preparing an Operating Requirements Manual and a draft of that manual will be made available to QCA as soon as practicable.

### **Dispute resolution process**

An expert dispute resolution process is not required in AU1 for matters relating to the undertaking's provisions. The QCA should, if necessary, be able to resolve disputes or questions between Queensland Rail and an access seeker.



# 1 Introduction

This document is in support of AU1 which has been given to the QCA as a voluntary draft access undertaking under section 136(1) of the QCA Act. AU1 is Queensland Rail's first draft access undertaking in relation to the declared service under the QCA Act for which Queensland Rail is the owner and operator.

## 1.1 The Declaration and an access undertaking

The declaring of a service under Part 5, Division 2 of the QCA Act provides a party seeking access to that service with a right to negotiate with the access provider for that service, and recourse to arbitration for disputes relating to terms and conditions for access that cannot be resolved through negotiation. Put simply, the declaration of a service opens that service up to access by access seekers – the access provider cannot use monopoly power to, for example, refuse to negotiate or to prevent or hinder access to the service.

The QCA Act allows for the development of access undertakings in relation to services – in particular, declared services. While the QCA Act requires an access provider for a declared service to negotiate with a third party access to that service, an access undertaking sets out details of the terms on which an owner or operator of a service undertakes to provide access to that service (whether or not it sets out other information about the provision of access to the service). An access undertaking under the QCA Act must be in writing and approved by the QCA.

Queensland Rail, as the owner and operator of a declared service may submit a voluntary draft access undertaking to the QCA for approval in relation to that declared service. Alternatively, the QCA may require Queensland Rail to submit a draft access undertaking for the declared service.

An access undertaking has effect under the QCA Act once it is approved by the QCA. The QCA Act provides mechanisms for resolving disputes about third party access to a declared service whether or not there is an approved access undertaking.

### Background information

#### The Declared Service applying to Queensland Rail

Under section 250(1)(b) of the QCA Act, the following service is taken to be declared under Part 5, Division 2 of the QCA Act:

*“the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating a railway for which Queensland Rail Limited, or a successor, assign or subsidiary of Queensland Rail Limited, is the railway manager<sup>1</sup>”.*

However, section 249 of the QCA Act effectively excludes:

*“the use of rail transport infrastructure for providing transportation by rail between Queensland and another State if – (a) the infrastructure is standard gauge track; and (b) the transportation is effected by using standard gauge rolling stock.”*

The reference to rail transport infrastructure is defined by reference to the TI Act as:

*“facilities necessary for operating a railway, including –*

*(a) railway track and works built for the railway including, for example – [cuttings, drainage works, excavations, land fill and track support earthworks]; and*

*(b) any of the following things that are associated with the railway's operation – [bridges, communication systems, machinery and other equipment, marshalling yards, notice boards, notice markers and signs,*

<sup>1</sup> Queensland Rail is the rail manager for rail transport infrastructure if it is accredited under the Rail Safety Act as the rail infrastructure manager for “railway operations” relating to the railway of which the rail transport infrastructure forms a part.

*overhead electrical power supply systems, over-track structures, platforms, power and communication cables, service roads, signalling facilities and equipment, stations, survey stations, pegs and marks, train operation control facilities, tunnels, under-track structures]; and*

*(c) vehicle parking and set down facilities for intending passengers for a railway that are controlled or owned by a railway manager or the chief executive; and*

*(d) pedestrian facilities, including footpath paving, for the railway that are controlled or owned by a railway manager or the chief executive;*

*but does not include other rail infrastructure.”*

Other rail infrastructure is defined in the TI Act as:

*“(a) freight centres or depots; or*

*(b) maintenance depots; or*

*(c) office buildings or housing; or*

*(d) rolling stock or other vehicles that operate on a railway; or*

*(e) workshops; or*

*(f) any railway track, works or other thing that is part of anything mentioned in paragraphs (a) to (e).”*

### 1.1.1 The Temporary Undertaking

The Temporary Undertaking currently applies to Queensland Rail despite it originally being approved in relation to QR Network. The Temporary Undertaking has been made to apply to Queensland Rail by law as part of the restructure of QR Limited associated with the formation and privatisation of QR National. Once AU1 is approved by the QCA, it will replace the Temporary Undertaking.

### 1.1.2 AU1

AU1 sets out a regulatory framework for third party access to the declared service described in section 250(1)(b) of the QCA Act. AU1 addresses matters such as:

- the rail network to which it applies;
- the process for a person to seek access to use that rail network to operate train services;
- the pricing principles for access charges including reference tariffs for the West Moreton System;
- NMP for the scheduling and prioritisation of train services;
- reporting obligations;
- a dispute resolution process;
- a Standard Access Agreement for coal carrying train services on the West Moreton System;
- the principles that other access agreements must comply with; and
- reference tariffs for coal carrying train services on the West Moreton System.

## 1.2 Consultation

Queensland Rail believes consultation with its customers and stakeholders is an essential part of developing a successful access undertaking. Queensland Rail wishes to build on the relationship that it has with its customers and stakeholders, which is exemplified by the cooperative efforts by Queensland Rail, customers and stakeholders during the 2011 flood recovery efforts around the State. As part of its consultation with customers and stakeholders, Queensland Rail:

- publicly released a working draft of AU1;
- held two public consultation forums;

- sought written comments from customers and stakeholders; and
- held individual meetings with, and otherwise engaged with, customers and stakeholders and their representatives,

prior to lodging AU1 with the QCA.

During this process customers and stakeholders have provided significant feedback, including producing confidential written submissions. Many of the provisions of AU1 have been informed from this feedback and Queensland Rail values the commitment demonstrated by its customers and stakeholders in contributing to the development of AU1.

While discussions with customers and stakeholders have influenced the Standard Access Agreement, Queensland Rail was not able to release to customers and stakeholders a working draft of the proposed Standard Access Agreement prior to giving AU1 to the QCA. Queensland Rail would have preferred to do so, but considered that it was important to commence the formal processes under the QCA Act.

However, Queensland Rail will continue to work with customers, stakeholders and the QCA to seek to facilitate appropriate outcomes in connection with AU1 (including the Standard Access Agreement).

In the preparation of AU1, Queensland Rail has sought to:

- strike an appropriate balance between Queensland Rail's legitimate business interests, the interests of access seekers and the wider public interest in having third party access to Queensland Rail's rail network;
- achieve an access undertaking that is easy to read and understand; and
- achieve an access undertaking that is fit for purpose in respect of Queensland Rail's business and the needs of customers to seek access to its rail network.

Should customers, stakeholders or the QCA desire further clarification or information in relation to this document, or to matters relating to AU1, please contact:

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## 1.3 Submission explaining AU1

The purpose of this document is to provide an outline of some key issues relevant to AU1 and to clarify matters raised by customers and other stakeholders during Queensland Rail's consultation process. This document does not provide commentary or submissions on each provision and aspect of AU1.

This document should be read in conjunction with AU1 but does not form part of AU1 or affect its interpretation.

Queensland Rail will provide further submissions, explanations and information as issues arise during the consideration of AU1 by the QCA.

## 2 The Queensland Rail Business

*AU1 is appropriate to Queensland Rail's business.*

### Key Points

- Queensland Rail is a wholly government owned corporation.
- Queensland Rail is not a part of the QR National group of companies.
- Queensland Rail's rail network serves a variety of train service types but is predominantly used by passenger and non-coal freight services.
- Queensland Rail's passenger train services and the majority of its rail network would not be commercially viable without transport service payments from the Queensland Government. Queensland Rail receives transport service payments for the provision of above rail passenger services and the provision of below rail infrastructure access.
- Competition exists between Queensland Rail's rail network and other modes of transport – although not, at present, in all instances, such as for coal carrying train services in the West Moreton System.
- Queensland Rail does not operate freight train services, has no intention of doing so and could not realistically be in a position to do so, within the regulatory period for AU1.
- All of Queensland Rail's passenger train services use either preserved train paths or train paths necessary to satisfy the Director General of DTMR's passenger service requirements under section 266 of the TI Act.
- Queensland Rail does not operate passenger train services in competition to third party operators and third party operators are not expected to seek to operate passenger train services in competition with Queensland Rail during the regulatory period for AU1.
- While a vertically integrated business with both above rail and below rail activities, Queensland Rail's above rail activities do not include freight train services and its passenger train services are not in competition with third party train services. As such, Queensland Rail is effectively acting as a non-vertically integrated access provider in respect of access to its rail network.

### 2.1 Corporate structure and business

Queensland Rail was registered as a corporation on 11 July 2008 and is a wholly government owned corporation. Queensland Rail was originally formed out of QR Limited's business that related to the operation of passenger train services. Queensland Rail was originally named QR Passenger Pty Ltd and was a subsidiary of QR Limited.

On 30 June 2010, as part of the restructure and privatisation process for QR National:

- Queensland Rail became an independent business – separate from the QR National corporate group; and
- the rail network previously managed by QR Network was divided between QR Network and Queensland Rail.

In simple terms, this resulted in QR Network (from the QR National group) continuing as the railway manager of the rail network in the Central Queensland Coal Region (including part of the North Coast Line) and Queensland Rail becoming the owner and railway manager of the remainder of the rail network previously managed by QR Network.

Therefore, from 30 June 2010, Queensland Rail changed from a business which principally operated passenger train services to a business that also manages a rail network comprised of approximately 8,000 km of Queensland freight and passenger railway track.

Queensland Rail's major businesses include passenger train services (including long distance trains), rail holidays, travel centres and the management of access to its rail network.

## 2.2 Scope of Queensland Rail's business activities and freight train services

Under Rule 2.1 of Queensland Rail's Constitution, Queensland Rail is limited to only undertaking activities that are within the scope of its objects under the Constitution<sup>2</sup> which are:

*"...to undertake, either directly or through a subsidiary:*

- (a) The provision of rail passenger transport services in Queensland for reward;*
- (b) The planning, development, construction, delivery and ongoing maintenance of rail transport infrastructure to be used for the provision of passenger rail and freight transport services in Queensland, and for the provision of access in (c);*
- (c) The provision of network rail services and access to rail networks owned or operated by the Company or its subsidiaries for reward;*
- (d) The provision of telecommunication services connected with the rail network infrastructure owned or operated by the Company or its subsidiaries;*
- (e) To do all other such acts as are necessary to fulfil the role of a railway manager and railway operator under the Transport Infrastructure Act 1994, and such other roles as may be conferred upon the Company by or under legislation, or under the Company's Statement of Corporate Intent or Corporate Plan, or as required to perform the functions mentioned in (a), (b) or (c); and*
- (f) Anything likely to complement or enhance the functions mentioned in (a), (b) or (c) or that is incidental to the objects set out in this rule 2.1.*

*The Company must not undertake any activities which do not come within the scope of the objects contained in this rule."*

The objects expressly include Queensland Rail's:

- provision of passenger train services;
- activities in relation to the planning, development, construction, delivery and ongoing maintenance of rail transport infrastructure for use by passenger and freight services; and
- provision of access to its rail network.

Queensland Rail is excluded from engaging in any activity that is not within the scope of its objects. For example, if Queensland Rail wishes to operate a train service (other than for passenger transport) and that activity is not within the scope of its objects, then Queensland Rail's Constitution would not permit Queensland Rail to engage in that activity.

Under rule 25 of Queensland Rail's Constitution, the Constitution can only be amended by Queensland Rail with the prior written consent of its Shareholding Ministers<sup>3</sup>. Such consent is unlikely to be given without Shareholding Ministers consulting with their respective Government Departments and the QCA to identify any significant implications for the regulatory regime applicable to Queensland Rail.

<sup>2</sup> A copy of Queensland Rail's Constitution is located at <http://www.queenslandrail.com.au/aboutus/documents/queensland-rail-approved-queensland-rail-limited-constitution%20final.pdf>.

<sup>3</sup> Queensland Rail's Shareholding Ministers are currently Minister for Finance, Natural Resources and the Arts and Minister for Transport and Multicultural Affairs.

## 2.3 Transport service payments

Most of Queensland Rail's rail network is supported by, and is commercially viable only because Queensland Rail receives, transport service payments from the Queensland Government. The absence of these transport service payments would result in large parts of the rail network becoming commercially unviable, as providing customers with access to the rail network on a commercial basis would not generally be affordable for customers.

Queensland Rail (as well as some private operators – for example, the operator of The Savannahlander) receives substantial transport service payments for the operation of passenger train services. Again those passenger train services are commercially viable only because of those transport service payments.

## 2.4 Access charges

Queensland Rail receives access charges in payment for the use of its rail network for the operation of train services by third party rolling stock operators.

Access prices for coal carrying train services in the West Moreton System are governed by a reference tariff that is set by the QCA. However, the access prices for other train services – for example, non-coal freight train services – are typically set by commercial negotiation between Queensland Rail and each customer, within the boundaries set out in the access undertaking.

In accordance with the pricing principles set out in the Temporary Undertaking and proposed in AU1, non-coal train services are priced between floor and ceiling limits (after taking into account transport service payments), but are usually closer to the floor than the ceiling. This is consistent with a lesser ability of Queensland Rail's customers to pay for access to the rail network, having regard to the nature of the commodity and, in each case, potential competition from other transport modes.

## 2.5 Mix of train services using Queensland Rail's rail network

Queensland Rail facilitates access to its rail network for a wide variety of train services including agricultural products, passenger train services, intermodal and general freight and bulk minerals. The needs of the traffics vary greatly due to their different supply chain dynamics, geographic locations, rail corridor characteristics and interactions with other rail traffics.

## 2.6 Competition with alternative transport modes

Queensland Rail competes with road transport for most non-coal train services as well as coastal shipping, air transport, slurry pipelines and other transport options. In this sense, a large part of Queensland Rail's rail network business is not truly monopolistic as it is actively competing with other transport modes. Generally, alternative transport options are available to transport by rail if the rail offering is not competitive. To this extent, third party access to the rail network is largely self-regulating from an economic perspective.

Road is a key competitor to the vast majority of Queensland Rail's rail network. Access agreements and pricing are primarily formed through commercial negotiation. Road transport has relatively little economic regulation compared to rail, providing it with a competitive advantage.

However, Queensland Rail acknowledges that, at present, coal carrying train services in the West Moreton System do not currently compete with alternative transport providers to have coal transported to port facilities.

## 2.7 Above rail operations

### 2.7.1 Queensland Rail does not compete with third party freight train services

Queensland Rail's above rail business continues to be comprised solely of passenger train services and those passenger train services are ones which the Queensland Government requires Queensland Rail to operate. Queensland Rail's passenger train services do not operate in competition with third party passenger train services and Queensland Rail does not operate freight train services.

As discussed in section 2.2 of this document, Queensland Rail is only able to undertake activities that are within the scope of the objects under Queensland Rail's Constitution. Significant processes are required to amend Queensland Rail's Constitution. This restricts the types of activities in which Queensland Rail can engage.

Aside from needing to satisfy any governance requirements, if Queensland Rail was to seek to operate freight train services there would be significant impediments to it doing so as it currently does not have the capability or rolling stock necessary to do so. Queensland Rail would require significant lead time in order to undertake all of the necessary preparatory activities including:

- purchasing rolling stock;
- obtaining relevant approvals and accreditation;
- establishing operations and yard facilities;
- employing suitably qualified and experienced staff and/or contractors;
- negotiating and executing haulage contracts (in competition with established operators); and
- arranging associated administrative requirements.

These are significant barriers to Queensland Rail entering the freight train service market. The time taken to put all of these arrangements in place would likely extend beyond the regulatory period proposed in AU1.

### 2.7.2 New third party passenger services are unlikely to enter into the passenger train service market in competition with Queensland Rail

Queensland Rail does not compete against third party operators of passenger train services and does not expect to do so during the regulatory period for AU1.

Similar lead time issues would arise should a third party consider entry into the passenger train service market in competition with Queensland Rail. In addition, the characteristics of passenger train services are such that they are not commercial without significant Queensland Government support in the form of transport service payments.

If the Queensland Government was to consider such a proposition, then it would be expected to take into consideration the current access regime and any changes that might be required including in relation to AU1. If the Queensland Government chose to facilitate such a third party operator, it may decide to direct Queensland Rail to amend AU1.

Competition between Queensland Rail and third parties in relation to the provision of passenger services is also discussed in section 3.3.2 of this document – including in relation to commerciality and transport service payments.

## 2.8 Passenger priority and preserved train paths

### 2.8.1 Special legislative treatment of passenger trains services

Queensland Rail operates almost all passenger train services in Queensland. Passenger train services receive special treatment under the TI Act as follows:

- section 265 of the TI Act – sets out an obligation for a railway manager to bring a delayed passenger train service back to its scheduled running time (including where this may result in a freight train service being delayed);
- section 266 of the TI Act – sets out a right for the Director General of the DTMR to identify the requirements for regularly scheduled passenger train services (e.g. identify the capacity requirements) and obliges railway managers to allocate rail capacity that is available or will become available to meet those requirements; and
- section 266A of the TI Act – provides for the preservation of train paths for regularly scheduled passenger train services and for non-coal freight services.

All of Queensland Rail's passenger train services use either preserved train paths or train paths that are the subject of the Director General of DTMR's passenger train service requirements.

The effect of the above provisions of the TI Act and the matters referred to in sections 2.7 and 3.3.2 of this document is that while Queensland Rail is a vertically integrated business with both above rail and below rail activities, Queensland Rail's above rail activities in operating passenger train services are not in competition with third party train services. As such, Queensland Rail is effectively acting as a non-vertically integrated access provider in respect of third party access to its rail network.

Section 3.2 of this document provides a detailed explanation of the operation of sections 266 and 266A of the TI Act and their interaction with Queensland Rail's business. Section 6.3 of this document provides a detailed explanation of the operation of section 265 of the TI Act

## 3 Application and Scope

### Overview – Part 1 of AU1

Part 1 of AU1 sets out:

- the duration of AU1;
- the scope and application of AU1;
- Queensland Rail's commitment:
  - to apply AU1 consistently between access seekers in the same circumstances; and
  - to not unfairly differentiate between access seeker or access holders;
- provisions regarding extensions to Queensland Rail's network; and
- the treatment of line diagrams.

### 3.1 Duration – AU1 term

*AU1 should have a term of at least four years but no more than five years commencing on the Approval Date.*

#### Key Points

- The proposed term for AU1 is consistent with relevant Australian rail regulatory precedent.
- There is a low risk of circumstances changing sufficiently during the proposed term to render AU1 irrelevant or inappropriate.
- Material issues regarding costs to, and lack of certainty for, Queensland Rail and stakeholders arise from having a term that is shorter or longer than the proposed term.

#### 3.1.1 Proposed term

Section 137(1) of the QCA Act requires an access undertaking to state its expiry date. The QCA must therefore assess the suitability of the expiry date for AU1.

One function of an access undertaking is to give a degree of certainty to all parties as to what the process for obtaining access will be over the regulatory period of the access undertaking. Too short a term may provide only limited certainty and too long a term risks circumstances changing so the access undertaking is either no longer relevant or is inappropriate.

Queensland Rail proposes that AU1 will have a term of no less than four years and no more than 5 years. For example, if AU1 were approved in the 2012-13 financial year, then AU1 would expire on 30 June 2017<sup>4</sup>.

Importantly, the reference tariffs for coal carrying train services on the West Moreton System (as set out in the Temporary Undertaking) will be maintained, with adjustments for CPI, until the reference tariffs are reviewed and a reset is approved by the QCA with effect from 1 July 2013 (refer to Part 5.2 of this document for discussion on the proposed West Moreton reference tariff reset). The reference tariffs when reset will therefore have a shorter term than AU1 given that they are intended to take effect from 1 July 2013.

<sup>4</sup> Depending upon the approval date, the term of AU1 may be less than five years but greater than four years to enable AU1 to terminate at the end of a financial year (i.e. 30 June)..

### 3.1.2 Regulatory precedent

AU1's proposed term is consistent with Australian rail regulatory precedent – for example:

- ARTC's first access undertaking in 2002 had a five year term<sup>5</sup>;
- ARTC's current access undertaking for interstate traffic has a ten year term with an annual price review<sup>6</sup>; and
- MTM's current access arrangement has a five year term<sup>7</sup>.

### 3.1.3 Queensland Rail's business environment

The nature of Queensland Rail's business means that there is little risk of circumstances changing to the extent of rendering AU1 irrelevant or inappropriate during the proposed term. In relation to most non-coal freight traffics, rail competes with road transport or other transport modes. This means that prices and conditions are competitively negotiated and if rail does not provide a competitive offering the traffic will transfer to an alternative transport solution (e.g. road).

As indicated in sections 2, 3.2 and 3.3.2 of this document, Queensland Rail does not directly compete with third parties as an operator of either passenger or freight train services and is not realistically likely to do so during the proposed term for AU1. As such, the complexity of past rail access undertakings by other Queensland rail access providers does not arise, and a lower risk exists of circumstances changing to the extent of rendering AU1 irrelevant or inappropriate.

In addition, the West Moreton reference tariff under the Temporary Undertaking is to be temporarily rolled over under AU1 (subject to CPI adjustments). AU1 proposes that this reference tariff will be reset early during the term of AU1. This proposal to reset the reference tariff also supports a longer term.

### 3.1.4 The cost of regulation

A shorter term would impose significant regulatory costs on Queensland Rail which would be passed through to train operators and their customers. The process for developing a new undertaking would need to begin within a relatively short time after the commencement of AU1. Regulatory processes tend to be costly and consume considerable resources from both the infrastructure provider and interested stakeholders. Queensland Rail is not aware of any overriding public interest that would justify Queensland Rail and customers bearing these additional costs.

The QCA and stakeholders have developed a considerable understanding of rail access issues in Queensland over the past 15 years. Queensland Rail submits that the experience and knowledge amassed in that time will assist in ensuring a robust regulatory assessment of AU1 with the consequential lowering of risks of potential unforeseen outcomes.

Queensland Rail considers that the proposed term for AU1:

- will provide the required commercial and regulatory certainty – without being either too long or too short; and
- is the most appropriate duration for Queensland Rail and its stakeholders.

<sup>5</sup> ACCC 2002. *Decision: Australian Rail Track Corporation Access Undertaking*, May 2002, p. 61.

<sup>6</sup> ACCC 2008. *Final Decision Australian Rail Track Corporation Access Undertaking – Interstate Rail Network*, July 2008, p. 22.

<sup>7</sup> Metro Trains Melbourne Pty Ltd Access Arrangement, 24 August 2011, Part 1.2, p. 2.

## 3.2 Treatment of passenger train services

***Queensland Rail should not be required to participate in AU1's access application process in relation to its above rail passenger business.***

***Queensland Rail's obligations under sections 266 and 266A of the TI Act will materially affect the allocation of capacity for regularly scheduled passenger train services (whether operated by Queensland Rail or a third party).***

### Key Points

- Train paths for regularly scheduled Queensland Rail passenger services are allocated to Queensland Rail through sections 266 and 266A of the TI Act.
- As capacity is allocated to regularly scheduled Queensland Rail passenger services through the provisions of the TI Act, the requirements in AU1 for capacity allocation (i.e. the access application process) do not apply to Queensland Rail.
- While a vertically integrated business with both above rail and below rail activities, Queensland Rail's above rail activities in operating passenger train services are not in competition with third party train services. As such, Queensland Rail is effectively acting as a non-vertically integrated access provider in respect of access to its rail network.
- Requirements for internal access agreements are not included in AU1 as Queensland Rail's regularly scheduled passenger services do not compete with regularly scheduled third party passenger services.
- Queensland Rail is obliged to give priority to the allocation of a train path to an operator of a regularly scheduled passenger train service if Queensland Rail is required to do so under section 266 of the TI Act to satisfy passenger service requirements.
- The effect of section 266A of the TI Act and the absence of competition in relation to regularly scheduled passenger train services will result in the operator of a relevant passenger train service having priority for the relevant preserved train path relating to that train service.
- The Director General of DTMR determines the passenger service requirements under section 266 of the TI Act and whether a preserved train path under section 266A of the TI Act can be allocated to a train service other than the type for which it was preserved.

### 3.2.1 Proposed position

AU1 relates to the negotiation of access by third party coal and non-coal freight access holders/seekers and third party passenger access holders/seekers. The access negotiation process under AU1 will not be artificially made to apply in relation to Queensland Rail's use of the rail network in respect of the operation of its own passenger services. That is, the internal arrangements within Queensland Rail for the allocation of capacity for the operation of Queensland Rail's passenger services on its network will not be determined in accordance with processes set out in AU1.

Clarification was sought from Queensland Rail during its consultation process in relation to the exclusion of Queensland Rail passenger train services from the access application process and whether Queensland Rail would be able to allocate capacity to itself at the expense of third parties. However, while Queensland Rail is both the railway manager of its network and an operator of passenger train services:

- Queensland Rail does not operate freight train services and can only undertake activities within the scope of its objects (see section 2.2 of this document);
- there are significant restrictions applying to Queensland Rail in competing with freight train services during the regulatory period for AU1 (see sections 2.7 and 3.3.2 of this document);

- it is unlikely that a third party would seek to compete with Queensland Rail in respect of the provision of passenger train services given the lack of commercial profitability and practical barriers (see sections 2.7 and 3.3.2 of this document);
- Queensland Rail is neither responsible for the identification of passenger service requirements (see section 3.2.2 of this document) nor the effects of the preserved train path obligations (see section 3.2.3 of this document) – these matters are prescribed by the TI Act and controlled by the Director General of DTMR; and
- Queensland Rail has statutory obligations with which it must comply for delayed passenger train services (see section 6.3 of this document).

In addition, there is no realistic prospect of the Queensland Government paying transport services payments to both Queensland Rail and a third party operator to establish competing passenger train services.

### 3.2.2 Passenger service requirements - section 266 of the TI Act

Section 266 of the TI Act provides, amongst other matters:

- A right for the Director General of DTMR to establish a process that regularly allows the Director General to identify “*passenger service requirements*” – that is, requirements for train paths for the following:
  - regularly scheduled passenger services on railway track in Queensland;
  - rolling stock that is to be used for a regularly scheduled passenger service and is being relocated for the purpose of providing the service.
- The Director General, by way of notice to a railway manager, may require the railway manager to provide information to enable the Director General to identify passenger service requirements.
- Once the Director General has identified the passenger service requirements, the Director General then notifies each rail transport operator, who is an accredited person under the Rail Safety Act, of the passenger service requirements relevant to the railway manager’s railway.
- Once notified of the Director General’s passenger service requirements, a railway manager **must** give priority to the passenger service requirements whenever a train path is, or will become, “available” for a railway manager to allocate. In complying with this obligation, the railway manager must not distinguish between different types of regularly scheduled passenger services.

Queensland Rail does not enter into an access agreement with the Director General for train paths that are to be allocated to satisfy passenger service requirements. Rather, Queensland Rail is obliged to give priority to the operator of the relevant passenger train service, which may be Queensland Rail itself or a third party, in respect of the allocation of the relevant train path. As such, Queensland Rail will, as applicable, either use the train path itself or offer the train path to the operator of the relevant passenger train service in preference to the operator of any other train service.

It is the Director General of DTMR rather than Queensland Rail who is entitled to determine the passenger service requirements. This is done under the TI Act and independently from the QCA Act or any access undertaking. Once those passenger service requirements have been determined by the Director General and notified to Queensland Rail, Queensland Rail must comply with section 266 of the TI Act and give priority to the allocation of train paths to satisfy those passenger service requirements.

The Director General will no doubt have substantial regard to the Government’s public transport objectives – particularly as the passenger train services referred to in the passenger service requirements will also require transport service payments (refer to section 2.3 of this document).

Train paths that have been identified by the Director General through section 266 of the TI Act (including train paths that will become available) must effectively be treated as committed. This means those train paths will not be available for allocation to access seekers unless the access seeker is the person who

will be providing the relevant passenger train service – as priority must be given to allocating those train paths to satisfy the Director General’s passenger service requirements.

Section 266 of the TI Act does not operate to strip existing access holders of their contracted train service entitlements under existing access agreements. However, from the time when an access agreement expires, priority must be given to allocating the train paths made available with that expiry to meet passenger service requirements, as applicable.

### 3.2.3 Preserved train paths – section 266A of the TI Act

The TI Act was amended in 2010 to include section 266A. Section 266A of the TI Act applies in respect of any train path that was, on 8 September 2010, allocated for the provision of:

- regularly scheduled passenger train services; or
- non-coal freight train services.

These train paths are known as “*preserved train paths*”.

If a preserved train path becomes available for allocation by Queensland Rail, Queensland Rail must only allocate that preserved train path to a train service that is the same type of train service as that which gave rise to the preserved train path. For example, a preserved train path arising from a regularly scheduled passenger train service must only be allocated to a train service that is a regularly scheduled passenger train service.

However, section 266A of the TI Act ceases to apply to a preserved train path if the Director General of DTMR has given:

- written notice that the train path is no longer subject to section 266A of the TI Act; or
- written consent to the allocation of that train path to a different type of train service.

Arguably, section 266A of the TI Act does not prevent Queensland Rail from allowing a preserved train path to be used for a different type of service when it is not being used for a train service of the type for which it has been preserved. For example, such a path could be used on an ‘ad hoc’ basis for a coal train service provided it remains available for a train service of the type for which it was preserved. However, the decision to allocate a preserved train path to a type of train service other than the type for which it was preserved is one for the Director General of DTMR and not Queensland Rail.

In relation to preserved train paths for regularly scheduled passenger train services, the preservation of those train paths when combined with the matters referred to in sections 2.3, 2.7 and 3.3.2 of this document will naturally result in an absence of competition for those train paths as practically there will be only one operator who is seeking to run the relevant passenger train service – whether Queensland Rail or a private operator – and that person will therefore have priority for the allocation of that train path.

## 3.3 Internal access agreements

***Queensland Rail should not be required to have “internal access agreements”.***

***Queensland Rail’s operation of passenger train services does not necessitate additional special protective provisions in AU1 for third party access seekers.***

### Key Points

- Internal access agreements may be required where a vertically integrated monopoly controls a business that operates in direct competition with a third party business.
- Queensland Rail does not directly compete with third parties as an operator of either passenger or freight train services and is not realistically likely to do so during the proposed term of AU1.
- Internal access agreements are not appropriate for Queensland Rail’s business.

### 3.3.1 Internal access agreements in previous rail access undertakings in Queensland

On 1 September 2008, QR Limited underwent a restructure that resulted in the formation of two wholly owned subsidiaries – QR Network and Queensland Rail (previously named QR Passenger Pty Ltd).

Prior to the restructure, QR Limited was a vertically integrated rail service provider with above rail businesses that competed directly with third party above rail businesses. Due to this, a degree of operational separation was required within QR Limited as part of its access undertaking. This resulted in the establishment of relatively self-contained business units including:

- units responsible for the operation of train services; and
- a unit responsible for the negotiation and provision of access to the below rail network.

As part of this operational separation, the QCA required QR Limited to include in its access undertakings an obligation to negotiate and maintain “internal access agreements” between its above rail business units and its below rail business unit. These were arrangements between the below rail business unit and the above rail business units that were similar to access agreements – but which were not actual contracts as QR Limited could not contract with itself as it was one legal entity.

The requirement by the QCA for internal access agreements was aimed at QR Limited’s above rail business units, which were in direct competition with third party access seekers, being granted access on terms no more favourable than the terms on which third party access seekers were granted access rights.

Internal access agreements were first required by the QCA in QR Limited’s 2001 access undertaking. Relevantly, the QCA’s 2000 Draft Decision stated:

*“As QR is vertically integrated, the nature of the terms and conditions on which its below-rail services are provided to its above-rail business groups is a significant issue for new third-party entrants. There is arguably considerable scope for QR to favour its own operation at the expense of third-party operators in the contestable market. This has the potential to distort the development of the above-rail market, including raising barriers to entry for new third-party operators, with associated implications for price levels and the quality of services provided to end-users...Consequently, the QCA considers that equivalence of the terms and conditions of internal and external access agreements should be a key objective of the framework established by the Undertaking.”<sup>8</sup>*

This statement by the QCA highlights that internal access agreements are required specifically when an access provider has an above rail operator which is operating, or likely to be operating, in direct competition with a third party operator to ensure that the access provider does not favour its own above rail operations through its treatment of access arrangements.

Subsequent to the restructure, because QR Limited, Queensland Rail and QR Network became distinct legal entities, these internal access agreements were required to be converted to access agreements.<sup>9</sup>

### 3.3.2 Queensland Rail is not competing with third party access seekers

Queensland Rail does not compete with third parties as an operator of either passenger or freight train services and is not realistically likely to do so during the proposed term for AU1.<sup>10</sup>

There is no realistic prospect of the Queensland Government paying transport service payments to both Queensland Rail and a third party operator to establish competing passenger train services. Given the lack of commerciality of passenger train services in the absence of such payments, there will effectively be no competition as there will only be one operator for a passenger train service using a preserved train path or a train path allocated to satisfy a passenger service requirement – whether Queensland Rail or a

<sup>8</sup> QCA’s Draft Decision on QR’s 2000 Draft Undertaking, December 2000, Volume 2 p. 119.

<sup>9</sup> Refer to clause 2.5.2(e) & (f) of the QR Network 2008 Access Undertaking.

<sup>10</sup> See: section 2.2 of this document regarding the scope of Queensland Rail’s business activities; section 2.7 of this document regarding practical restrictions on Queensland Rail competing with freight train services and on third parties competing with Queensland Rail’s passenger train services; section 3.2 of this document regarding Queensland Rail’s passenger service requirement and preserved train path obligations; and section 2.3 of this document regarding transport service payments.

third party – during the regulatory period for AU1. As Queensland Rail is not operating, and is unlikely to operate, in direct competition with other above rail operators during the regulatory period for AU1, a requirement for internal access agreements (and the resultant organisational restructuring and associated costs) is not required in AU1.

To impose requirements relating to internal access agreements without a reasonable prospect of competition with third party operators exposes Queensland Rail to significant costs and inefficiencies without any clear benefits to customers, the public interest or the furthering of competition in upstream or downstream markets. In addition, any such costs and inefficiencies would – given the nature of Queensland Rail’s business – ultimately be borne by customers or the Queensland Government through increased transport service payments.

Queensland Rail also submits that its approach is consistent with relevant rail regulatory precedent – for example, MTM.

## Background information

### MTM – Victoria

In Victoria, MTM is the metropolitan infrastructure manager and the above rail metropolitan passenger train service operator.

MTM’s metropolitan network consists of 15 train routes over 400 km of “broad gauge” track, which are used predominantly for passenger train services within Melbourne. Certain lines are also used by regional passenger train services terminating at the Southern Cross and Flinders Street Stations, and some lines are used by freight train services. MTM is not required to negotiate internal access agreements with itself.<sup>11</sup>

### 3.3.3 NMP

All capacity for Queensland Rail’s regularly scheduled passenger train services becomes “committed” capacity through the provisions of sections 266 and 266A of the TI Act. Therefore, there is no requirement in AU1 for Queensland Rail passenger train services to participate with AU1’s access application process. This committed capacity will be entered into the MTP in accordance with AU1’s principles in the NMP.

AU1 does not require Queensland Rail to enter into internal access agreements as Queensland Rail is not operating, and is unlikely to operate, in direct competition with other above rail operators during the regulatory period for AU1.

The NMP are part of AU1 and will be approved by the QCA as part of the QCA’s approval of AU1. Consequently, an amendment to the NMP is an amendment to AU1 and requires the approval of the QCA.

The NMP provide certainty as to how operators are treated (including Queensland Rail) in scheduling train services for the MTP and DTP and also in relation to the prioritisation of train services on the day of operation. The NMP apply to both Queensland Rail and other train operators.

Attachment 1 contains a detailed analysis of Queensland Rail’s approach to the treatment of passenger services on its network.

<sup>11</sup> Section 2 of the Essential Services Commission’s Victorian Rail Access Regime Ring Fencing Rules sets out ringfencing requirements in relation to organisational separation including requirements that an access provider not arrange for its access activities business unit to provide services to an other activities business unit or a related body corporate of the access provider (other than shared services) unless the relevant service is provided pursuant to a written and executed agreement. However, the Essential Services Commission, in its February 2010 “Review of the Victorian Rail Access Regime Final Report: Volume II: Detailed Analysis and Discussion of Issues” (p.93) states: “Given that there is currently little vertical integration in the Victorian rail industry, the Ring Fencing Rules are not applied to any access providers. The regime could include a statutory requirement for access providers to maintain separate accounting records for access activities, and provide the ability for the Commission to make Ring Fencing Rules, but need not make the establishment of those rules mandatory.”

## 3.4 Scope of access under AU1

***AU1's scope applies to approximately 98% of the declared service.***

***AU1's scope does not apply to providing access for a freight train services to those parts of the rail network provided for the benefit of passengers and passenger train services.***

### **Key Points**

- AU1 applies to the declared service with the exception of access by non-passenger train services to those parts of the rail network provided for the benefit of passengers or passenger train services including:
  - stations and platforms used for passengers or passenger train services; and
  - yards and associated facilities used to stage, maintain or store rolling stock used for passenger train services.
- Queensland Rail considers it unlikely that freight train services will require access to the excluded passenger infrastructure.
- The approach taken in AU1 is consistent with past QCA approved rail access undertakings in Queensland.
- Extending AU1 to providing an access seeker for a non-passenger train service with access to the parts of the rail network provided for the benefit of passengers and passenger train services will create unnecessary complexity in AU1 in respect of a scenario that is unlikely to arise. This is more efficiently addressed during the term of AU1 on a case by case basis through Queensland Rail's negotiations with an access seeker, or, if necessary, by an access determination of the QCA, in accordance with the QCA Act.
- A voluntary access undertaking in relation to a declared service is not required to apply to the whole of that declared service. Those parts of a declared service to which an undertaking does not apply may still be accessed by third parties through the QCA Act.
- The declared service does not necessarily extend to yards and associated facilities used to stage, maintain or store rolling stock.

### **3.4.1 The relationship between an access undertaking and the declared service**

An access undertaking for a declared service outlines the process and requirements that an owner or operator of that declared service will comply with in providing third party access to that service.

There is no requirement in the QCA Act that a voluntary access undertaking must apply to all of a declared service. This is reflected in the QCA's 2000 Draft Decision on QR Limited's Draft Undertaking which stated:

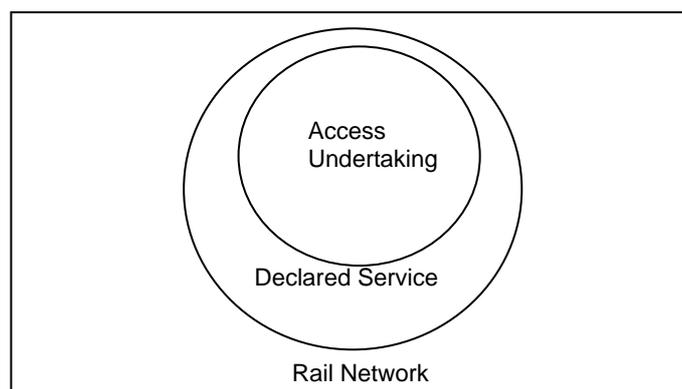
*"It is clear that declared services need not be subject to an undertaking although the QCA is empowered under the QCA Act to request an undertaking from an access provider in relation to the provision of declared services. If access is sought to declared services not covered by an undertaking, the arbitration machinery contained in the QCA Act would be available."<sup>12</sup>*

Where an access undertaking does not apply to part of the declared service, access may still be sought by an access seeker to that part of the declared service through the QCA Act.

Figure 1 below provides a hypothetical example of an interaction between a rail network, a declared service and an access undertaking. Figure 1 is not to scale and does not represent any existing declared service or access undertaking or AU1. Figure 1 is for indicative purposes only. Figure 1 shows diagrammatically how an access undertaking may be a subset of a declared service and a declared service may be a subset of the services provided by a particular rail network.

<sup>12</sup> The QCA Draft Decision on QR's Draft Undertaking – Volume 2, December 2000' p. 141 in footnote 61.

Figure 1 – An example of the possible interaction between a rail network, a declaration and an access undertaking



### 3.4.2 The scope of AU1

AU1 applies to the declared service with the exception of access by non-passenger train services to those parts of the rail network provided for the benefit of passengers or passenger train services including:

- stations and platforms used predominantly for passengers or passenger train services; and
- yards and associated facilities used to stage, maintain or store rolling stock used for passenger train services.

This approach is consistent with the approach in the QCA approved Temporary Undertaking (refer section 3.4.3 below).

Queensland Rail considers that it is unlikely that freight train services will require access to this passenger infrastructure. Queensland Rail believes that the operators of freight train services should be aware that this infrastructure was not built to meet their requirements and use by freight train services could cause unreasonable disruption to passenger operations. In general, freight train services already have established operational facilities such as crew change points, marshalling areas and designated areas to attach and detach wagons. AU1 aims to be 'fit for purpose' applying to those assets most likely to attract access seekers.

The exclusion of yards and associated facilities used to stage, maintain or store rolling stock is also intended to provide clarity. However, the use of those facilities does not necessarily form part of the declared service and AU1 is not intended to extend to services outside the declared service.

### 3.4.3 AU1's approach compared to previous QCA approved access undertakings

AU1's proposed approach is consistent, in principle, with the approach approved by the QCA in QR Network's 2008 Access Undertaking which was associated with QR Limited's corporate restructure (see section 2.1 of this document for further information regarding QR Limited's restructure).

As part of the restructure, Queensland Rail was allocated ownership of stations, platforms and the majority of Mayne Yard at Bowen Hills. The QCA Act provides that an access undertaking may only be submitted by the owner or operator of a service. Therefore, QR Network could only submit an access undertaking that related to rail transport infrastructure owned or operated by QR Network. Notably the QCA, when considering the implications of the corporate restructure on the access undertaking, did not seek to require stations and platforms to be owned or operated by QR Network. This resulted in that infrastructure not being included within the scope of QR Network's 2008 Access Undertaking.

The line diagrams in QR Network's 2008 Access Undertaking provided a delineation of the declared assets managed by QR Network and its related corporations. The most significant of the below rail

facilities that the line diagrams identified as remaining outside of QR Network's management responsibility were the majority of Mayne Yard and stations and platforms.

Additionally, QR Network's 2008 Access Undertaking stated that where an access seeker is reasonably of the opinion that part of the declared service not covered by the undertaking is required for the purpose of obtaining access to the declared service, the access seeker could seek that QR Network obtain ownership of the relevant rail transport infrastructure and amend the line diagrams accordingly.<sup>13</sup>

However, the explicit exception to this was in relation to stations and platforms. QR Network's 2008 Access Undertaking provided that the management of stations and platforms, including the provision or procurement of appropriate levels of maintenance and investment for stations and platforms, was to be the responsibility of a "QR Operational Business Group" rather than QR Network.<sup>14</sup>

QR Network's 2008 Access Undertaking was intended to essentially be on the same terms as QR Limited's 2006 Access Undertaking but for amendments arising out of the restructure of QR Limited. The approach of QR Network's 2008 Access Undertaking on this issue is a translation of the similar approach taken in QR Limited's 2006 Access Undertaking.

#### **3.4.4 A 'fit for purpose' undertaking**

A request by an access seeker for access to stations and platforms, which were predominantly designed for passenger train services, for a freight train service will be dealt with in accordance with the QCA Act rather than through AU1. This will result in the request being considered on its individual merits, without unduly complicating AU1 for access which may never, or only rarely, be sought.

As highlighted in section 3.4.2 of this document, freight train services already have established operational facilities such as crew change points, marshalling areas and designated areas to attach and detach wagons. Queensland Rail considers that it is unlikely that freight train services will require significant access to passenger rail infrastructure – such access may never, or only rarely, be required.

Expanding the scope of AU1 to incorporate access to passenger oriented stations and platforms would require Queensland Rail to seek to detail the circumstances where Queensland Rail was or was not obliged to provide access. For example, access may not be appropriate where:

- a passenger station or platform has not been built with the appropriate specifications for the purpose sought by a freight train service; or
- there are implications for safety.

This could potentially result in detailed and complex provisions being unnecessarily included in AU1 – as those provisions would need to be able to address all potential access requests and circumstances relating to various types of freight train services and stations, platforms and other passenger rail infrastructure. Provisions of that nature may also potentially result in either a risk of gaps or the need for general catch-all provisions. Queensland Rail does not consider that such provisions are likely to provide sufficient certainty for either itself or access seekers.

If an access seeker happens to request access to, for example, passenger stations and platforms for a freight train service and that request for access relates to the declared service, then the QCA Act requires Queensland Rail to negotiate with that access seeker in relation to providing access and, if the parties do not reach agreement, the matter may be referred to the QCA for arbitration. This approach allows the access seeker, Queensland Rail and, if necessary, the QCA to focus on the actual facts and circumstance of the request for access rather than AU1 attempting to set out a potentially complex process to address all potential requests for that type of access.

As highlighted in section 3.4.3 of this document, Queensland Rail's approach is consistent with previous Queensland regulatory precedent by the QCA.

<sup>13</sup> Paragraph 2.1(f) of QR Network's 2008 Access Undertaking.

<sup>14</sup> Subparagraphs 2.2(g)(i) and 3.1(c)(iii) of QR Network's 2008 Access Undertaking.

Therefore, it is reasonable that AU1 not apply to access for non-passenger train services to those parts of the rail network provided for the benefit of passengers or passenger train services including stations and platforms used predominantly for passengers or passenger train services and yards and associated facilities used to stage, maintain or store rolling stock used for passenger train services.

## 3.5 Extensions

***AU1 includes provisions regarding the construction and funding of extensions that protect Queensland Rail's legitimate business interests, provide certainty as to when Queensland Rail will commit to construct extensions and preserve the ability to achieve negotiated outcomes for extensions.***

### Key Points

- It is in Queensland Rail's interest to increase traffic and tonnage volumes on its rail network.
- Queensland Rail substantially modified its initial working draft position regarding extensions in response to feedback from customers and other stakeholders.
- Queensland Rail cannot be obliged to fund extensions and has a right to own extensions.
- Complex provisions relating to extensions are not warranted in Queensland Rail's circumstances.
- Queensland Rail's preference is for parties to arrive at negotiated outcomes for extensions.

### 3.5.1 Outcomes from consultation

On 31 August 2011, Queensland Rail publicly released a working draft of AU1 for public comment. Clause 1.4 of that working draft stated that:

*"Queensland Rail may in its absolute discretion undertake any Extensions necessary to provide the Additional Capacity required to grant Access Rights requested by an Access Seeker."*

Customers and other stakeholders provided feedback to Queensland Rail on this drafting. In particular, customers and other stakeholders:

- advised that it would be beneficial for AU1 to set out criteria where Queensland Rail would undertake an extension; and
- acknowledged that under the QCA Act Queensland Rail could not be obliged to pay part or all of the cost of an expansion.

Queensland Rail has made significant amendments to AU1 in response to this feedback. Queensland Rail redrafted clause 1.4 of the working draft in response to customer and stakeholder feedback.

### 3.5.2 AU1's treatment of extensions

Clause 1.4 of AU1 provides clarity in relation to extensions to its rail network. AU1 specifies criteria that must be satisfied in order for Queensland Rail to commit to undertake an extension including that Queensland Rail is not obliged to pay part or all of the cost of an extension – although Queensland Rail may choose to fund an extension.

The provision ensures that Queensland Rail has sufficient power to only extend its network under specific conditions and in accordance with its legitimate business interests. The circumstances in which Queensland Rail will commit to construct extensions of its rail infrastructure include matters relating to:

- the financial capacity of the access seeker to fund the extension;

- the technical and operational feasibility of the extension, including its consistency with Queensland Rail's engineering and operational requirements and the safe and reliable provision of access; and
- contractual arrangements, including requirements with respect to the execution of access agreements and other contractual arrangements.

However, clause 1.4 is not intended to prevent or otherwise restrict Queensland Rail and an Access Seeker from negotiating arrangements relating to extensions that are commercially acceptable to each party.

## Background information

### QCA powers under the QCA Act relating to extensions

An access undertaking may include provisions "*relating to extending the facility*".<sup>15</sup> However, the QCA's powers are limited when making access determinations under the QCA Act relating to the extending of a facility.

For example, under section 119 of the QCA Act, the QCA must not make an access determination:

- that is inconsistent with an approved access undertaking;<sup>16</sup>
- that, in effect, results in the access seeker, or someone else, becoming the owner, or one of the owners, of the facility, without the existing owner's agreement;<sup>17</sup>
- that, in effect, requires an access provider to pay some or all of the costs of extending the facility;<sup>18</sup>
- that requires an access provider to extend a facility unless:
  - if an approved voluntary access undertaking applies, the requirement is consistent with a requirement imposed under a voluntary access undertaking;<sup>19</sup>
  - the QCA is satisfied that the extension will be technically and economically feasible and consistent with the safe and reliable operation of the facility;<sup>20</sup>
  - the QCA is satisfied that the legitimate business interests of the owner and operator of the facility are protected;<sup>21</sup> and
- that requires an access provider to pay all or some of the costs of extending a facility except to the extent that such a requirement is consistent with a requirement imposed under an approved voluntary access undertaking.<sup>22</sup>

### 3.5.3 Queensland Rail is incentivised to facilitate extensions

Queensland Rail is incentivised to increase traffic and tonnage volumes on its rail network, as this improves revenues and the commercial robustness of the rail network. As such, Queensland Rail has incentives to facilitate commercially viable extensions to its network.

<sup>15</sup> Section 137(2)(g) of the QCA Act.

<sup>16</sup> Section 119(1)(a) of the QCA Act.

<sup>17</sup> Section 119(2)(b) of the QCA Act. See also the QCA's Final Decision on QR Network's 2010 Draft Access Undertaking, September 2010, p.32.

<sup>18</sup> Section 119(2)(c) of the QCA Act; see also the QCA's Final Decision on QR Network's 2010 DAU, September 2010, pp 25 & 28 where the QCA confirmed that it cannot oblige an infrastructure owner to include in an access undertaking an obligation to wholly or partly fund an extension to its network.

<sup>19</sup> Section 119(4)(a) of the QCA Act.

<sup>20</sup> Sections 119(4B)(a) and 119(5)(b)(i) of the QCA Act.

<sup>21</sup> Sections 119(4B)(b) and 119(5)(b)(ii) and (iii) of the QCA Act.

<sup>22</sup> Sections 119(4A) and 119(5)(c) of the QCA Act. See also the QCA's Final Decision on QR Network's 2010 Draft Access Undertaking, September 2010, pp 25 & 28.

### **3.5.4 Queensland Rail to own extensions**

Section 119(2)(b) of the QCA Act states that any access determination by the QCA cannot result in an access seeker, or someone else, becoming the owner of a facility without the existing owner's agreement. This principle was affirmed by the QCA in its 2010 Final Decision on QR Network's 2010 Draft Access Undertaking.<sup>23</sup> On this basis, AU1 provides that all extensions will be owned and managed by Queensland Rail unless otherwise agreed by Queensland Rail.

### **3.5.5 Construction and funding of extensions**

Queensland Rail considers clause 1.4 of AU1 provides sufficient certainty for customers and stakeholders regarding the circumstances when Queensland Rail will construct an extension, while at the same time protecting Queensland Rail's legitimate business interests.

AU1 does not deviate from the principle that Queensland Rail cannot be required to pay for the costs of an extension. However, AU1 does not preclude Queensland Rail from deciding to fund an extension.<sup>24</sup>

Queensland Rail's preference is that the construction and funding of extensions to its rail network required by customers and stakeholders occurs as a result of negotiation. This may include instances where Queensland Rail is not able to fund extensions, and instead facilitates arrangements for customers to fund such extensions.

For example, Queensland Rail has been providing and continues to provide ongoing assistance to the Southern Surat User Group in relation to the Miles Wandoan upgrade where Queensland Rail has facilitated meetings, provided resources and expertise, as well as intellectual property, to assist all parties involved. Queensland Rail will continue to participate in such projects.

Queensland Rail is aware of the complexities in QR Network's 2010 Access Undertaking in relation to these issues. Queensland Rail considers that it would be better for all interested parties to avoid such complexities if possible – as they are not warranted in Queensland Rail's circumstances.

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<sup>23</sup> QCA's Final Decision on QR Network's 2010 DAU, September 2010, p 32.

<sup>24</sup> Refer to clause 1.4.3(c) of AU1.

## 4 Negotiation Process

### Overview – Part 3 of AU1

Part 3 of AU1, the 'Negotiation Process', sets out:

- access application process including:
  - acknowledgement of access requests;
  - procedures relating to indicative access proposals (IAPs);
  - negotiation process;
  - required timeframes;
- access agreement requirements including:
  - the granting of access rights where there are two or more parties competing for the same capacity;
  - the principles applying to access agreements (including for relinquishments, transfers and resumptions); and
  - the development of new standard access agreements;
- the prudential requirements for access seekers; and
- the confidentiality provisions.

### 4.1 Ringfencing and commercial-in-confidence

***Ringfencing provisions are not appropriate for Queensland Rail's business.***

#### Key Points

- Ringfencing requirements are only relevant for a vertically integrated monopoly that is competing with third party operations in downstream competitive markets.
- While a vertically integrated business with both above rail and below rail activities, Queensland Rail's above rail activities in operating passenger train services are not in competition with third party train services. As such, Queensland Rail is effectively acting as a non-vertically integrated access provider in respect of access to its rail network.
- Australian regulatory precedent demonstrates that ringfencing provisions are not appropriate where an integrated organisation is not operating in competition with third parties.
- Confidentiality provisions included in AU1 to protect the confidential information of access seekers and access holders.
- Queensland Rail will maintain separate accounting records in accordance with section 163 of the QCA Act.

## Background information

### A definition of ringfencing

An integrated rail provider will typically:

- provide below rail services by being the manager of the rail network infrastructure; and
- provide above rail service by being a rail haulage operator who participates in the above rail train market in competition with third party train services.

It is necessary for third parties to provide their confidential information to the infrastructure provider when, for example:

- applying for access to the below rail network; and
- operating as an access holder on the below rail network (e.g. the rail network infrastructure manager will collect data on third party train service performance).

Ringfencing aims to prevent an integrated rail provider, who is operating in competition with third party businesses, from the deliberate and discriminatory transfer of third party confidential information from the monopoly below rail business to its own competing, above rail business. From a competition perspective this transfer of information is undesirable, as the integrated rail provider's above rail business may then receive a competitive advantage gained through insights into the competing third party above rail business.

The QCA has referred to ringfencing in the context of the perception that a vertically integrated rail enterprise could pass information from its monopoly business to its above rail business providing its above rail business with a competitive advantage over third party above rail businesses:

*"Broadly, ring-fencing is the separation of business functions within an enterprise for organisational and accounting purposes, with management of information flows between the separated business functions. It is based on the premise that the operation and management of the monopoly assets are placed on a stand-alone basis to be managed independently of any other business arms, in particular the competitive arm, of the enterprise."*<sup>25</sup>

The Independent Competition and Regulatory Commission of the ACT has referred to ringfencing as follows:

*"Ring fencing is the identification and separation of business activities, costs, and decision making within an integrated entity where part of the entity is providing monopoly services and another is providing services in a competitive market. Its purpose is to ensure that businesses operating in regulated monopoly industries do not use their monopoly power, or collude with associated businesses, to give associated businesses an unfair advantage over their market competitors. Ring fencing is intended to reduce or eliminate both incentives and opportunities for such anticompetitive behaviour. Specifically it aims at preventing the deliberate and discriminatory transfer of information and resources from a monopoly business to an associated business..."*<sup>26</sup>

Ringfencing measures can typically be characterised as:

- restrictions on information flows and discriminatory decision-making to guard against:
  - confidential information being used for anti-competitive purposes, or
  - monopoly power being exercised through discriminatory or preferential treatment of associated business activities.
- legal separation – a requirement for monopoly services to be provided in a separate legal structure.
- ownership separation – as above, except the separate legal entities must not have common ownership.
- management separation – restrictions on personnel having dual management roles across ringfenced and non-ringfenced business.
- accounting separation – requirement for the provision of separate financial information, usually supported by cost allocation and various other financial guidelines.

What ringfencing measures are used in any given situation will be influenced by various matters including, for example:

- the nature and circumstance of the monopoly business and the associated business activities in

<sup>25</sup> QCA's Final Decision on QR's 2000 Draft Access Undertaking, July 2001. section 3.1 p. 58.

<sup>26</sup> Independent Competition and Regulatory Commission, "Ring Fencing Guidelines For Gas and Electricity Network Service Operators in the ACT", November 2002, p.2.

competitive markets;

- the potential competitive consequence of confidential information being used for anti-competitive purposes or of monopoly power being exercised to benefit associated business activities in competitive markets;
- the powers of the relevant economic regulator; and
- the consequences of applying those ringfencing measures on both the monopoly business and third parties.

#### 4.1.1 Regulatory precedent

The ringfencing arrangements set for the former QR Limited, which operated above rail freight services, were integral to addressing the potential for that business to prevent or hinder access to competing third party access seekers to benefit its own operations. The QCA in its 2001 Final Decision on QR's Access Undertaking states:

*"As a vertically integrated enterprise, QR could potentially use its monopoly power in the below rail market to gain an unfair competitive advantage in the above-rail market. For example, QR's monopoly arm could pass confidential information about third-party operators to its competitive arm providing its above-rail business with an inappropriate competitive advantage."*<sup>27</sup>

While a vertically integrated business with both above rail and below rail activities, Queensland Rail's above rail activities in operating passenger train services are not in competition with third party train services. As such, Queensland Rail is effectively acting as a non-vertically integrated access provider in respect of access to its rail network (see sections 2.8 and 3.2 of this document).

The nature and structure of Queensland Rail's business means there is no real scope for Queensland Rail to use its market power to limit competition in the above rail markets. Highly prescriptive ringfencing requirements would therefore impose significant costs on Queensland Rail without benefiting third party access seekers or access holders or promoting effective competition in downstream markets.

Australian regulatory precedent also supports the approach that ringfencing provisions are not appropriate where an integrated organisation is not operating in competition with third parties. For example, RailCorp in New South Wales and V/Line (regional network) in Victoria are integrated rail businesses with above and below rail functions and, similar to Queensland Rail, their above rail train services do not operate in competition with third party train services.

RailCorp is owned by the NSW Government and operates passenger rail services throughout the Sydney metropolitan, outer-urban, and regional areas. RailCorp also owns and maintains the metropolitan rail network and provides access to freight operators in the area, and is regulated by the Independent Pricing and Regulatory Tribunal. RailCorp's access undertaking:

- does not include specific ringfencing arrangements; and
- does include requirements regarding the separation of business accounts.

The Victorian Rail Access Regime, which came into effect in 2006, contains *Ring-Fencing Rules* (the Rules). While the Rules exist, they have never been applied to any access providers in Victoria. In February 2010, the Essential Services Commission (the regulator), under instruction from the Minister for Finance, conducted an independent review into the effectiveness and applicability of the Victorian Rail Access Regime considering the current and likely future structure of the industry.

The Essential Services Commission's review acknowledged that while the Rules are in place, they have not been applied to any access providers, as there is currently little vertical integration in the Victorian

<sup>27</sup> QCA's Final Decision on QR's 2000 Draft Access Undertaking, July 2001. section 3.1 p. 58. The Final Decision also states on p.57: "Ring-fencing - due to the vertically integrated structure, it is necessary for there to be appropriate ring-fencing arrangements that protect the legitimate business interests of all parties".

rail industry.<sup>28</sup> Further, it recommended that the Rules be less prescriptive and be replaced by ringfencing and account keeping guidelines.<sup>29</sup>

#### **4.1.2 Accounting separation**

Queensland Rail is committed to the principles of accounting separation between its declared service and non-declared services. Section 163(1) of the QCA Act requires Queensland Rail to keep accounting records, in a form approved by the QCA, for the declared service separately from the accounting records of its other operations.

Also, the QCA may require a cost allocation manual under section 159 of the QCA Act. Queensland Rail submitted a revised cost allocation manual to the QCA in December 2011. The QCA has subsequently sought public consultation on the cost allocation manual.

The QCA Act enables the QCA to address both accounting separation and cost allocation. Queensland Rail acknowledges this and will work with the QCA to address these matters in accordance with the QCA Act. However, Queensland Rail does not consider it necessary to duplicate these requirements in AU1.

#### **4.1.3 Confidential information**

Queensland Rail is committed to protecting its customers' confidential information. Confidentiality provisions have been included in section 2.2 of AU1 in relation to the management of the confidential information of access seekers and access holders.

#### **4.1.4 PWC Supporting Analysis**

In determining Queensland Rail's approach to ringfencing, Queensland Rail commissioned PWC to analyse the appropriateness of ringfencing provisions, having regard to Queensland Rail's business model and considering past determinations by Australian rail regulators. Queensland Rail has attached the PWC supporting analysis to this document for the QCA's consideration (refer Attachment 2).

## **4.2 Transfer, relinquishment and resumption**

***AU1 includes appropriate transfer, relinquishment and resumption provisions.***

### **Key Points**

- Access holders can relinquish all or part of their access rights in accordance with the provisions in the Access Agreement Principles and Standard Access Agreement.
- Access holders can assign, novate or otherwise transfer their interest in an access agreement to a third party in accordance with the terms of that access agreement, with the prior written consent of Queensland Rail.
- The provisions in AU1 are consistent with rail access requirements in other States. For example, the prior written consent of the rail manager prior to a transfer taking place is required in relation to:
  - ARTC's Interstate Access Agreement (2008);
  - V/Line's Standard Access Agreement (Freight Services);

<sup>28</sup> Essential Services Commission. 2010. Review of the Victorian Rail Access Regime Final Report: Volume II Analysis and Discussion of Issues. February 2010. pg. 93.

<sup>29</sup> Essential Services Commission. 2010. Review of the Victorian Rail Access Regime Final Report: Volume II Analysis and Discussion of Issues. February 2010. pg. 94.

- MTM's Standard Access Agreement;
- DBCT's Standard User Agreement;
- ARTC's Indicative Access Holder Agreement (Hunter Valley) except where it is for a period of less than 12 months.

Queensland Rail competes with road and other forms of transport (i.e. coastal shipping, air transport, slurry pipelines and other transport modes). In this sense, a large part of Queensland Rail's rail network business is not truly monopolistic as it is actively competing with other transport modes.

Queensland Rail has an incentive to maintain the efficient allocation of capacity in order to facilitate a commercially robust rail network. As such, AU1 provides for the transfer, relinquishment and resumption of capacity.

#### **4.2.1 Relinquishment**

Queensland Rail's working draft of AU1 was released for comment on 31 August 2011. It did not include provision for relinquishment. Customers and stakeholders expressed a strong desire for relinquishment provisions to be included in AU1. Queensland Rail has included relinquishment provisions in AU1 in response to customer feedback, and these are referred to in the access agreement principles set out in Schedule C of AU1 and the Standard Access Agreement set out in Schedule D of AU1.

Queensland Rail has sought to simplify the calculation of relinquishment fees with adjustments where the relinquished capacity is used by Queensland Rail to grant access rights to a new access seeker (whether as a result of Queensland Rail's normal business operations or because of an arrangement that the access holder has to "transfer" that capacity to that access seeker).

#### **4.2.2 Transfers**

Access holders can assign, novate or otherwise transfer their interest in an access agreement to a third party in accordance with the terms of that access agreement, with the prior written consent of Queensland Rail (Clause 2.7.6 of AU1). These provisions allow access holders to transfer unwanted capacity rights, subject to the prior written consent of Queensland Rail. Queensland Rail's consent is subject to whether the assignee has the financial resources and capability to perform the obligations and the accreditation to operate the train service.

Queensland Rail is incentivised to be efficient due to market forces (refer section 2 of this document) and therefore, to allocate capacity efficiently. The provisions in AU1 are consistent with rail access requirements in other States. The prior written consent of the rail manager prior to a transfer taking place is required in relation to:

- ARTC's Interstate Access Agreement (2008);
- V/Line's Standard Access Agreement (Freight Services);
- MTM's Standard Access Agreement;
- DBCT's Standard User Agreement<sup>30</sup>; and
- ARTC's Indicative Access Holder Agreement (Hunter Valley) except where it is for a period of less than 12 months.

Queensland Rail does not have a monopoly over most of its rail network and is incentivised to allocate capacity efficiently. Like other similar rail access regimes around Australia, it is reasonable that Queensland Rail's prior consent be required prior to a transfer.

<sup>30</sup> Both the 2006 and 2010 Draft Access Undertaking Standard User Agreements included provisions for transfers with the prior written agreement of the infrastructure provider.

The ACCC's comments in its 2002 Decision on ARTC's access undertaking support the approach taken by Queensland Rail in relation to transfers. The ACCC advised that:

*“ARTC has also proposed that an operator may cancel train paths or assign them to third parties (**subject to the approval of ARTC**).*

*The Commission accepts these provisions of the Undertaking and considers that it satisfies the legislative criteria in section 44ZZA(3) (of the Trade Practices Act 1974<sup>31</sup>).<sup>32</sup> (emphasis added)*

## 4.3 Queuing of access applications

**‘Queuing’ is not appropriate for Queensland Rail’s business.**

### Key Points

- Queuing is appropriate where an integrated organisation competes with third party operators. Queensland Rail does not compete with third parties for access to capacity in its rail network. Rather, capacity allocation to Queensland Rail’s regularly scheduled passenger services is determined through sections 266 and 266A of the TI Act. As such, queuing is not appropriate for Queensland Rail’s business.
- AU1 seeks to move away from a queue based capacity allocation to a principles-based approach to capacity allocation. Queuing imposes unnecessary administrative costs upon Queensland Rail for no clear competitive benefit.
- Queensland Rail’s proposed capacity management framework is consistent with those put in place by other below rail providers in Australia, which allow capacity to be allocated to the access seeker which in the below rail provider’s opinion, is most favourable or will best utilise the available capacity.

### 4.3.1 Capacity allocation under AU1

Under Part 7 of the Temporary Undertaking, access rights are required to be allocated to the first access seeker with whom Queensland Rail can negotiate and execute an acceptable Access Agreement (Clause 7.4.1(a)) – except in the case of mutually exclusive access applications, where the Temporary Undertaking sets out a process for the formation of a queue.

The Temporary Undertaking allows for the reordering of the queue under certain circumstances. The queuing arrangements were introduced in QR Limited’s 2006 Access Undertaking to provide access seekers with certainty in relation to obtaining access rights where capacity is scarce, particularly in light of the perception that QR Limited could, where capacity is scarce, potentially decide to allocate capacity to its own above rail business rather than to a third party operator.

### 4.3.2 Limited relevance to Queensland Rail’s operations

In its Final Decision of ARTC’s Access Undertaking (Interstate Rail Network) in 2008, the ACCC reviewed the capacity allocation arrangements in other jurisdictions. The ACCC noted that the QCA required a queuing system in the rail access regime in Queensland. Such a system was deemed to be most relevant when two or more access seekers were seeking mutually exclusive access rights and that such a mechanism would provide access seekers with some certainty over access rights under negotiation as well as assist with an access seeker’s forward planning.

While the ACCC acknowledged the merits of the queuing system adopted by QR Limited, it considered that the efficacy of a queuing system in the case of ARTC was questionable given that the underlying

<sup>31</sup> On 1 January 2011 the *Trade Practices Act 1974* was renamed the *Competition and Consumer Act 2010*.

<sup>32</sup> ACCC’s Decision on ARTC Access Undertaking (May 2002), p. xviii.

intention of the queuing system was to limit the market power of QR Limited (given that QR Limited could use the negotiating process as a means by which access applications from third parties could be stalled in favour of QR Limited's own above rail operations). As ARTC is not vertically integrated, the ACCC considered there were fewer concerns and a queuing system was not warranted.<sup>33</sup>

Queensland Rail, however, is a significantly different business from the vertically integrated QR Limited, QR Network or the QR National company group. Similar to ARTC, Queensland Rail does not operate in competition with third party above rail businesses (refer sections 2.7, 3.2 and 3.3.2 of this document). While the queuing requirements may have merit for a vertically integrated organisation that is competing with third party above rail businesses for scarce capacity, it is not appropriate where this is not the case.

Additionally, a queue is more suitable where there is a single product type that is railed at a similar price, such as coal on the central Queensland coal region. Under such circumstances the time of lodgement of an access application may be important because, to a large extent, the service is homogenous – whereas, Queensland Rail provides access for a diverse mix of train services.

When considering the potential need for a queuing mechanism, it is also important to consider the potential costs or disadvantages of queuing including, for example, the additional regulatory burden on Queensland Rail, potential for delays in negotiating access and gaming by access seekers including to attempt to reserve capacity at the expense of other access seekers.

Despite the absence of queuing provisions, Queensland Rail has included in AU1 criteria upon which it will decide between competing access applications<sup>34</sup> in respect of which access application(s) will be the most favourable to Queensland Rail. A key feature of AU1 is the commercial negotiation of access. This is consistent with the QCA's Final Approval of QR Limited's 2006 Draft Access Undertaking where the QCA stated:

*"The QCA Act makes it clear that commercial negotiation is to play a central role when an access seeker is seeking access rights."*<sup>35</sup>

Queensland Rail's proposed capacity management framework is consistent with those put in place by other below rail providers in Australia, which allow capacity to be allocated to the access seeker which in the business' opinion is most favourable or will best utilise the available capacity.

### **4.3.3 Queuing arrangements create unnecessary administrative costs**

A guiding principle for AU1 is the reduction of complexity and unnecessary detail and the provision of greater flexibility for Queensland Rail and access seekers to negotiate on access terms appropriate for the particular circumstances.

The Temporary Undertaking's provisions require Queensland Rail to continuously adjust a queue resulting in unnecessary administrative costs. Under AU1 it is proposed that capacity will be allocated based on the most favourable outcome for the business, which includes consideration of various factors – for example, the likely access charges, cost and risk to the business and the term of the access agreement.

AU1 is also guided by the economic principle of ensuring the benefits of the access undertaking, in terms of the certainty and guidance it provides to access seekers, do not exceed the cost to Queensland Rail of administering the access arrangements.

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<sup>33</sup> Australian Competition and Consumer Commission, *Final Decision – Australian Rail Track Corporation: Access Undertaking – Interstate Rail Network*, July 2008. p. 186.

<sup>34</sup> That is, access applications where the grant of access rights to one or more of those access seekers would result in access rights not being able to be granted to the other access seekers.

<sup>35</sup> QCA's Final Approval of QR Limited's draft 2006 access undertaking, p.16.

#### **4.3.4 PWC analysis**

Attachment 3 is PWC's supporting analysis regarding AU1's approach to capacity allocation where there are competing access requests for the same capacity.

## 5 Pricing Principles

### Overview – Part 4 of AU1

Part 4 of AU1, the 'Pricing Principles', sets out AU1's:

- pricing objectives;
- pricing limits and price differentiation principles;
- reference tariffs;
- rate review provisions; and
- provisions regarding the QCA Levy

### 5.1 Pricing principles

*The pricing principles set out in AU1 are appropriate to Queensland Rail's business and consistent with regulatory precedent.*

#### Key Point

- The pricing principles are largely consistent with the Temporary Undertaking and overarching principles from current and past access undertakings for QR Network, QR Limited and ARTC.

AU1 pricing principles have been developed taking into consideration the overarching principles of the access undertakings of QR Network, QR Limited and ARTC. The proposed pricing provisions are largely consistent with the pricing principles in the Temporary Undertaking, which in turn are based on generally accepted regulatory principles. For the purposes of AU1, Queensland Rail has not sought to deviate substantially from the practical effect of the pricing principles in the Temporary Undertaking.

Some differences exist due to formatting and structural changes which seek to clarify and simplify existing arrangements and remove unnecessary detail and the need to better reflect Queensland Rail's commercial circumstances. However, Queensland Rail has sought to achieve this whilst retaining the general intent of the provisions from the Temporary Undertaking.

PWC has undertaken a detailed analysis of the AU1's Part 3 Pricing Principles. The PWC supporting analysis is attached to this document for the QCA's consideration (refer Attachment 4).

### 5.2 Reference tariff reset

*AU1 temporarily rolls forward the reference tariff rates under the Temporary Undertaking with CPI adjustments subject to a review and reset of those reference tariffs being submitted to the QCA by 30 June 2013.*

#### Key Points

- AU1 retains the current reference tariff rates applying to the West Moreton System under the Temporary Undertaking (with CPI adjustments) subject to a reference tariff reset to be submitted to the QCA no later than 30 June 2013 (or such longer time as agreed with the QCA).
- Queensland Rail intends to consult with its customers and stakeholders to seek to establish an agreed reference tariff.

AU1 retains the current reference tariff rates applying to the West Moreton System under the Temporary Undertaking (with CPI adjustments) subject to a reference tariff reset that is to be submitted by Queensland Rail to the QCA by 30 June 2013 (or such longer time as agreed with the QCA). The reference tariff rates applying to the West Moreton System under the Temporary Undertaking were developed based upon supporting information that was forecast out to June 2013.

Queensland Rail intends to consult with its customers and stakeholders to seek to establish an agreed reference tariff. The reset will facilitate this by providing the time needed to seek to resolve the many complex matters that arise around the development and approval of a reference tariff, including the development of the requisite regulatory building blocks. These regulatory building blocks will provide both Queensland Rail and its customers with certainty and transparency.

This approach will also mean that the approval of AU1 is not delayed by the development of new reference tariffs. It additionally benefits Queensland Rail, customers and stakeholders by giving them an opportunity to specifically focus on the issue of reference tariffs during the time period allocated to the development of the reference tariff reset.

To ensure that there is certainty that the reference tariffs will be reviewed and reset in a timely manner, if Queensland Rail does not submit proposed new reference tariffs on time, then it will be taken to have submitted the then current reference tariffs for review by the QCA. While Queensland Rail is not seeking to rely on this provision, it provides certainty that the review of reference tariffs will occur.

If the reference tariffs were reset as part of AU1, then the QCA would have had various powers under the QCA Act in connection with the approval or refusal to approve those reference tariffs. To maintain that position, any submission or deemed submission of new reference tariffs will be treated as if it were a draft access undertaking submitted by Queensland Rail under the QCA Act in response to an initial undertaking notice given by the QCA. It is proposed that Queensland Rail and the QCA will act in accordance with the provisions of the QCA Act as though this were the case.

This approach provides a simple means of preserving the QCA position under the QCA Act without detailing a specific approval process in AU1.

## 6 Network Management Principles

### Overview – Part 5 and Schedule C of AU1

Part 5 and Schedule C of AU1 sets out the NMP including:

- Train planning principles and train control principles including:
  - the MTP principles:
  - the DTP principles: and
  - the traffic management decision making matrix.

### 6.1 NMP

The NMP specify the requirements applicable to the MTP, DTP and the train control principles. The NMP are intended to ensure that all operators are treated consistently and transparently in respect of scheduling and on the day of operation.

Queensland Rail's passenger train services and the train services of all third party access holders will be scheduled by Queensland Rail into the MTP and DTP and are subject to the NMP.

### 6.2 Scheduling of Possessions

*The NMP include specific provisions relating to Possessions.*

*Possessions are necessary for the safe and efficient running of Queensland Rail's rail network.*

#### Key Points

- Various types of Possessions need to be provided for in the NMP including Planned Possessions, Urgent Possessions and Emergency Possessions.
- The safe running of the rail network and Queensland Rail's accreditation are dependent upon Queensland Rail being able to implement Planned Possessions, Urgent Possessions, Emergency Possessions and other Operational Constraints as necessary.
- The NMP strike an appropriate balance between Queensland Rail's need to schedule Possessions and an access holder's interest in the operation of its train services.

During Queensland Rail's consultation with customers and stakeholders, Queensland Rail was asked for clarification in relation to the requirement for possessions on the rail network.

Possessions and operational constraints are important aspects of Queensland Rail's ability to maintain and enhance its rail network. Possessions and operational constraints are needed to manage safety and interface risks and are an essential part of managing the rail network. The safe running of the rail network is dependent upon Queensland Rail being able to implement planned possessions, urgent possessions, emergency possessions and other operational constraints as necessary.

Possessions are also an important part of Queensland Rail maintaining its accreditation under the Rail Safety Act, as that accreditation is focused on Queensland Rail's railway operations being undertaken safely. If Queensland Rail's accreditation was to be suspended or withdrawn for any part of the rail network, then Queensland Rail would not be able to allow train services to operate on that part of the rail network.

## Background information

### Possessions and operational constraints

AU1 defines various types of possessions as well as what is meant by “operational constraints”.

A **Possession** is a temporary closure or occupation by Queensland Rail of part of its rail network (including closure of track or isolation of any electrical overhead traction system) for the purpose of carrying out:

- the construction of any rail transport infrastructure to improve, upgrade, expand, extend, replace or vary the whole or any part of the rail network;
- any management, maintenance or operational activities relating to the rail network, including the improvement, maintenance, repair, modification, installation, removal, renewal or decommissioning of the whole or any part of the rail network;
- any inspections or investigations of the rail network; or
- other work or other activities on or in the proximity of the rail network;

An **Emergency Possession** is a Possession that is required to rectify a serious fault with the rail network:

- that is considered by Queensland Rail to be dangerous or potentially dangerous to any person; or
- where severe speed restrictions have been imposed that affect the scheduled train services of access holders,

and that Queensland Rail intends to carry out within less than five business days after the detection of the serious fault.

An **Urgent Possession** is a Possession that is required to correct problems in relation to the rail network that are considered by Queensland Rail to be potentially dangerous to persons or property and that Queensland Rail intends to carry out within less than three months after the detection of the problem (other than an Emergency Possession).

A **Planned Possession** is a Possession (other than an Urgent Possession or Emergency Possession) where that Possession is entered in the MTP or DTP and adversely affects the operation of train services.

An **Operational Constraint** means any temporary or permanent constraint on the operation or use of any part of the rail network imposed by Queensland Rail as it considers necessary in relation to the proper, efficient or safe operation or management of the rail network (including speed restrictions, load restrictions, Planned Possessions, Urgent Possessions, Emergency Possessions and signalling or overhead restrictions).

Provisions have been included in the NMP that specifically relate to Possessions – for example:

- a new or modified Planned Possession may be included in the MTP where the modification would result in an access holder’s scheduled train services not being met, if Queensland Rail:
  - has consulted with that access holder; and
  - to the extent that the modification is not within the scope of that access holder’s train service entitlement, has used reasonable endeavours to mitigate the adverse impacts on that access holder;
- any of the following:
  - a modification to an existing Planned Possession;
  - the creation of an Urgent Possession; or
  - any other Operational Constraint affecting the DTP,

may be included in a DTP (at least two business days prior to the day of operation, and prior to the DTP being scheduled) where this would result in an access holder’s scheduled train services not being met, if Queensland Rail:

- has consulted with that access holder; and

- to the extent that the modification is not within the scope of that access holder's train service entitlement, has agreed the modifications with the access holder (such agreement not to be unreasonably withheld);
- an Emergency Possession may be included in a DTP (at least two business days prior to the day of operation, and prior to the DTP being scheduled) provided that if the variation would result in an access holder's scheduled train services not being met then Queensland Rail must consult with the access holder; and
- an Emergency Possession may be included in a DTP (once it has been scheduled) without the need for Queensland Rail to consult with an access holder where, before the commencement of that access holder's train service, Queensland Rail notifies the access holder that an Emergency Possession is required.

As these examples illustrate the NMP strike an appropriate balance between the interests of access holders in operating train services in accordance with their train service entitlement and scheduled DTPs and Queensland Rail's business interests in relation to ensuring the safe operation of the rail network.

The ability for a rail infrastructure manager to establish network management principles in relation to the scheduling of possessions and operational constraints and restrictions is commonplace in rail access regimes. For example, both ARTC and QR Network have requirements in relation to possessions and network management principles. However, each rail infrastructure manager's network management principles will usually be tailored to the business circumstances of that rail infrastructure manager.

AU1's approach in the NMP in relation to Possessions is necessary for the safe and efficient running of Queensland Rail's rail network and as such is consistent with Queensland Rail's legitimate business interests, the public interest and the overarching interests of access seekers/holders.

In addition, it may also be relevant to consider that in the context of coal carrying train services on the West Moreton System to which a reference tariff applies, AU1 and the Standard Access Agreement provide that Queensland Rail is not entitled to take or pay charges for train services that do not operate because of Queensland Rail Cause. Queensland Rail Cause is defined as follows:

***"Queensland Rail Cause"** means Queensland Rail's inability to make the Network available for the operation of Train Services in accordance with a Train Service Entitlement as a result of:*

- (a) *a Planned Possession, Urgent Possession or Emergency Possession;*
- (b) *a Force Majeure Event affecting Queensland Rail; or*
- (c) *any other action by Queensland Rail other than Queensland Rail exercising a right or complying with an obligation in accordance with this Undertaking, any applicable Law or the relevant Access Agreement,*

*except where Queensland Rail's inability to do so is in any way attributable to the Operator, another Rail Transport Operator (other than Queensland Rail) or any other person."*<sup>36</sup>

Despite Queensland Rail's underlying motivation to encourage the commercial use of its rail network, in the context of coal carrying train services on the West Moreton System to which a reference tariff applies, Queensland Rail also has a more explicit financial incentive to avoid being unable to make the rail network available because of a Possession. However, any motivation or incentive to avoid Possessions will always be subject to Queensland Rail's commitment to the safe operation of the rail network.

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<sup>36</sup> See clause 7.1 of the AU1 and clause 26.1 of the Standard Access Agreement.

## 6.3 Passenger priority legislation

### Key Points

- Queensland Rail is obliged to endeavour to bring delayed passenger train services back on time ahead of non-passenger train services. This is due to the requirements of section 265 of the TI Act.
- AU1 and the Standard Access Agreement are consistent with section 265 of the TI Act.

Queensland Rail's passenger priority obligations arise under the TI Act.

Section 265 of the TI Act states:

**“265 Delayed passenger services**

- (1) *A railway manager must endeavour to bring a passenger service that is delayed back to its scheduled running time.*
- (2) *In complying with subsection (1), a railway manager must not distinguish between different types of regularly scheduled passenger services.*
- (3) *Subsection (2) does not limit the matters that the railway manager may consider as relevant when complying with subsection (1).*

*Examples of relevant matter—*

*1 a train transporting livestock*

*2 train service entitlements for services other than passenger services.”*

Queensland Rail is obliged by statute to endeavour to bring delayed passenger train services back on time ahead of non-passenger train services.

In doing this, Queensland Rail may consider relevant matters such as whether livestock is being transported (e.g. Queensland Rail can prioritise a train service containing livestock ahead of a passenger train service to ensure the humane treatment of livestock) or may consider a train service entitlement and related matters. But Queensland Rail is not permitted to distinguish between different types of regularly scheduled passenger services.

AU1 and the Standard Access Agreement are consistent with the requirements of section 265 of the TI Act.

## 7 Other Provisions

### 7.1 Website material

#### Key Points

- Many of the Temporary Undertaking's more prescriptive technical requirements were due to the vertically integrated nature of the corporate group of which QR Network forms a part.
- As Queensland Rail does not compete with third party above rail operators, Queensland Rail has not included those prescriptive technical requirements from AU1 and will make technical requirements and information available as documents on its website.
- This will result in a more efficient, timely process for the updating of those requirements rather than being required to lodge a draft amending access undertaking.

AU1 sets out a process for access seekers to negotiate access terms and simplifies certain matters so they are clearer and easier to understand by comparison to the Temporary Undertaking.

Many of the Temporary Undertaking's more prescriptive requirements in relation to technical matters (for example, safety and interface requirements and environmental management requirements) arose out of QR Network being part of a vertically integrated corporate group that involved related parties of QR Network providing above rail services in competition with third parties. This is similar to the position originally taken when above and below rail services were being provided by a single vertically integrated entity as was the case for QR's 2000 Draft Access Undertaking. The QCA stated in its Draft Decision on QR's 2000 Draft Access Undertaking:

*"QR's vertical integration gives rise to a conflict of interest because of its ability to use rolling stock, safety and environmental requirements in the Undertaking to hinder access to its below-rail services, thereby protecting its above-rail business groups."<sup>37</sup>*

and

*"...the QCA is mindful that QR, as a vertically integrated provider, faces a conflict of interest in its ability to use the interface standards to hinder access to its below-rail services, thereby protecting the revenues of its above-rail operations. Consequently, in considering the interface provisions of QR's Draft Undertaking, the QCA has carefully balanced these competing interests."<sup>38</sup>*

As Queensland Rail effectively does not compete with third party above rail operators, Queensland Rail has chosen for AU1 either not to include some of those requirements or to refer to them as being made available by Queensland Rail to access seekers – for example, on its website.

This approach will also assist Queensland Rail to ensure that the information is up to date and readily available for customers.

For instance, Queensland Rail intends that various documents and information helpful to access seekers will be made available through Queensland Rail's website – for example:

- line diagrams for the rail network;
- information, standards and requirements with which an interface risk assessment and interface risk management plan must be consistent – including, for example, a sample interface risk management plan;
- information, standards and requirements for operating plans;

<sup>37</sup> QCA's Draft Decision on QR's 2000 Draft Access Undertaking, December 2000, Volume 2 p. 301.

<sup>38</sup> QCA's Draft Decision on QR's 2000 Draft Access Undertaking, December 2000, Volume 2 p. 302.

- CPI escalated inputs for reference tariffs; and
- application forms for access applications (i.e. conceptual operating plans).

Making information available in this way will enable Queensland Rail to update materials without having to go through a draft amending access undertaking process, thereby providing greater flexibility and efficiency. This is a reasonable position – particularly given that Queensland Rail is effectively not competing with third party above rail operators.

## 7.2 Operating requirements

### Key Points

- The Standard Access Agreement provides that various technical matters be set out in “Operating Requirements”. These “Operating Requirements” will be updatable and are intended to be applicable generally to operators on Queensland Rail’s network.
- Queensland Rail intends that a draft of an Operating Requirements Manual will be made available to QCA as soon as practicable.

The Standard Access Agreement refers to Queensland Rail making “Operating Requirements” available to the operator. The “Operating Requirements” are practices, standards, systems, protocols, requirements, rules, policies and other information in relation to or in connection with train control and the access to and use of the network by operators – for example, interface management and coordination requirements, safeworking procedures, safety standards, emergency and investigation procedures, requirements for the management of network incidents and environmental requirements, as published by Queensland Rail from time to time. The Standard Access Agreement requires that Queensland Rail and the operator comply with the “Operating Requirements”.

The Standard Access Agreement sets out a process for Queensland Rail to amend “Operating Requirements”. If in Queensland Rail’s opinion (acting reasonably) a proposed amendment is likely to materially adversely affect the operator, then Queensland Rail will provide reasonable notice of the proposed amendment (including details of the proposed amendment, the proposed implementation date and advice on the period during which the operator can consult with Queensland Rail in relation to the proposed amendment).

If Queensland Rail amends the “Operating Requirements”, Queensland Rail will allow at least ten business days for the operator to amend its processes in order to comply, unless Queensland Rail reasonably requires immediate compliance for safety reasons.

Queensland Rail is currently developing an Operating Requirements Manual. The Operating Requirements Manual will set out various technical requirements including interface risk assessment and interface risk management plan requirements, safeworking procedures and safety standards, emergency and investigation procedures and environmental requirements. It will be placed on Queensland Rail’s website and updated by Queensland Rail from time to time.

Queensland Rail intends to release a draft of the Operating Requirements Manual as soon as practicable, so that the QCA and customers have an opportunity to consider the draft Operating Requirements Manual in the context of the Standard Access Agreement during the QCA’s consultation process.

## 7.3 AU1's dispute resolution process

***An expert dispute resolution process is not required in AU1.***

### **Key Points**

- The Temporary Undertaking includes an expert dispute resolution process for disputes or questions arising between Queensland Rail and access seekers.
- The QCA should, if necessary, be able to resolve disputes or questions between Queensland Rail and an access seeker. AU1 does not need an expert dispute resolution process.

AU1 includes a dispute resolution process that applies to disputes concerning the application of the provisions of AU1. The Temporary Undertaking included a possible referral to an expert of a dispute or question arising between an access seeker and QR Network.

Queensland Rail believes the need for expert referral, in relation to application of AU1, is redundant given that the QCA should be able to resolve access-related issues – as provided by the QCA Act. Consequently expert determination does not form part of the dispute resolution process under AU1.

Queensland Rail has used a more typical dispute resolution provision in the Standard Access Agreement which includes an expert dispute resolution process.

# Attachment 1: PWC Supporting Analysis – Treatment of Passenger Services

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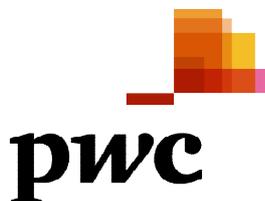
# *Queensland Rail*

## Treatment of passenger services

*Queensland Rail*

*Supporting analysis for  
submission to the QCA*

*28 March 2012*



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---

## 1.1 Introduction

Queensland Rail commenced business independently from the QR National corporate group on 1 July 2010. Queensland Rail's primary business activities are the delivery of public transport through the provision of passenger rail services and supporting private freight services through the provision of rail infrastructure.

Since 1 July 2010, Queensland Rail has been providing access to its below-rail network under QR Network's 2008 Access Undertaking (as at 30 June 2010) to the extent that it was made to apply to Queensland Rail by a transfer notice and project direction (Transfer Notice) dated 29 June 2010 under the *Infrastructure Investment (Asset Restructuring and Disposal) Act 2009* (Qld) (Temporary Undertaking).

In light of the new structure of the business and the approaching expiry of the Temporary Undertaking, Queensland Rail is preparing a draft access undertaking (Queensland Rail Access Undertaking 1 (AU1)) to submit to the Queensland Competition Authority (QCA). With AU1 Queensland Rail seeks to provide an access undertaking that better suits the operations and requirements of Queensland Rail, whilst preserving the basic process for access seekers to negotiate access terms, and simplifying the Temporary Undertaking to be better understood by all parties.

Queensland Rail is proposing that the internal arrangements for its own use of its rail network for passenger services will not be determined according to the processes and terms set out in AU1. Rather, AU1 will apply only to external operators of freight services and, should future circumstances require, external operators of passenger services.

This documents sets out the reasons and justification for this proposal.

## 1.2 Background

### 1.2.1 *The Declared Service*

Section 250 (1) (b) of the *Queensland Competition Act 1997* (QCA Act) sets out the following service as a declared service under Part 5 of the QCA Act:

*the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating a railway for which Queensland Rail Limited, or a successor, assign or subsidiary of Queensland Rail Limited, is the railway manager*

However, the use of rail transport infrastructure for providing transportation by rail between Queensland and another State on standard gauge track and using standard gauge rolling stock is effectively not treated as part of that declared service (Section 249).

The declared service determines the scope of the service that is legislated for regulated third party access with respect to Queensland Rail's infrastructure including, to the extent applicable, passenger dedicated assets, such as platforms, stations and related infrastructure. This declared service is consistent with the declaration by regulation that previously applied under the *Queensland Competition Authority Regulation 2007* prior to the insertion of section 250 of the QCA Act.

### *1.2.2 Past treatment of passenger services*

Prior to 2008, QR Limited comprised below and above-rail business units, including above-rail freight operations. In 2008, the business was separated into a number of legally separate subsidiaries, including QR Network Pty Ltd (QR Network) which operated the below-rail infrastructure, QR Passenger Pty Ltd (QR Passenger) which operated the passenger business and QR National which provided above-rail freight and haulage services, particularly to Queensland coal mines. The business structure was implemented to facilitate the separation of the management of below-rail assets from the operation of train services.

Under QR Network's 2008 Access Undertaking (2008AU) all of QR Limited's above-rail services, including QR Passenger, were required to negotiate access in accordance with the access undertaking. These arrangements also included requirements for the negotiation of access agreements between the business' below-rail business (QR Network) and the other QR business groups (e.g. QR National and QR Passenger).

### *1.2.3 Proposed treatment of passenger services*

The scope of the proposed AU1 relates to third-parties for coal and non-coal freight train services and third-party passenger train services, including long-distance services, seeking access to the declared service from Queensland Rail. Access is defined as:

- (a) The non-exclusive right to use a specified section of the Network; and*
- (b) For non-passenger Train Services, excludes the right to use those parts of the Network provided for the benefit of passengers or passenger Train Services including:*
  - (i) stations and platforms used predominantly for passengers or passenger Train Services; and*
  - (ii) yards and associated facilities used to stage, maintain or store Rolling Stock used for passenger Train Services,*

*for the purposes of operating Train Services.*

This approach is generally consistent with the scope of the 2008AU. However, unlike the 2008AU, AU1 will also allow for the negotiation of access to facilities such as stations and platforms by third-party passenger operators. The 2008AU did not extend to stations and platforms.

Queensland Rail proposes that AU1 will not require Queensland Rail's above-rail business to "negotiate" with its below-rail business for access to use the rail network for passenger services. That is, the internal arrangements within Queensland Rail for the operation of Queensland Rail's passenger services on its Network are not required to be determined in accordance with the processes and terms of AU1. However some aspects of AU1, such as the Network Management Principles, will still apply to Queensland Rail's passenger services.

## 1.3 Reasons and justification

An access undertaking is a document which establishes the terms and conditions under which an infrastructure provider is willing to offer or negotiate access with access seekers. An access undertaking seeks to clearly specify the terms and conditions on which access will be made available to parties and provides for the equitable treatment of all access seekers. This is particularly important for infrastructure providers which are vertically-integrated and may be competing with third-party above-rail operators for access, or likely to compete with third-party above-rail operators for access in the future.

While there may be in-principle grounds for requiring Queensland Rail's above-rail services, which only include passenger services, to negotiate access in accordance with the access undertaking, in practice this is not justified in the particular circumstances of Queensland Rail because:

- there is no likelihood that Queensland Rail will operate above-rail freight train services in competition with other providers of these services;
- there is no material likelihood of the emergence of a competing third-party passenger provider in the medium term;
- the allocation of capacity allocation to Queensland Rail's passenger services is determined outside the formal access undertaking process, via the provisions of the *Transport Infrastructure Act 1994* (TIA); and
- the process for determining an access agreement under the undertaking would create additional administrative cost for Queensland Rail, while generating very minimal competitive benefits to users.

The proposed arrangements for Queensland Rail's passenger services are consistent with the arrangements for similar rail business in other Australian jurisdictions, such as Metro Train Melbourne in Victoria, and RailCorp in New South Wales (NSW).

Each of these matters is discussed in further detail below.

### 1.3.1 *No likelihood of operating above-rail freight train services*

The access arrangements for QR Network, under the 2008AU, required that all QR business groups operating above-rail services negotiate access through the formal access undertaking process. These arrangements were required to address the potential for the business to use its market power to favour its own above-rail operations through access conditions, particularly as this related to its above-rail coal and freight operations.

Queensland Rail is a significantly different business from QR Limited and its related subsidiaries. Queensland Rail is a single legal entity and its primary business activity is the delivery of government services in the form of passenger rail services, rather than the for-profit above-rail services for haulage of coal and bulk freight.

Under Rule 2.1 of Queensland Rail's Constitution, Queensland Rail is limited to only undertaking activities that are within the scope of its objects under the Constitution which are:

*'to undertake, either directly or through a subsidiary:*

- (a) The provision of rail passenger transport services in Queensland for reward;*
- (b) The planning, development, construction, delivery and ongoing maintenance of rail transport infrastructure to be used for the provision of passenger rail and freight transport services in Queensland, and for the provision of access in (c);*
- (c) The provision of network rail services and access to rail networks owned or operated by the Company or its subsidiaries for reward;*
- (d) The provision of telecommunication services connected with the rail network infrastructure owned or operated by the Company or its subsidiaries;*
- (e) To do all other such acts as are necessary to fulfil the role of a railway manager and railway operator under the Transport Infrastructure Act 1994, and such other roles as may be conferred upon the Company by or under legislation, or under the Company's Statement of Corporate Intent or Corporate Plan, or as required to perform the functions mentioned in (a), (b) or (c); and*
- (f) Anything likely to complement or enhance the functions mentioned in (a), (b) or (c) or that is incidental to the objects set out in this rule 2.1.'*

Queensland Rail is excluded from engaging in any activity that is not within the scope of its objects.

While Queensland Rail can amend its Constitution, in accordance with rule 25 of the Constitution, this requires the prior written consent of its Shareholding Ministers.<sup>1</sup> Any consent is unlikely to be given by Shareholding Ministers without consulting with their respective Government Departments and the QCA.

Beyond the limits to Queensland Rail's objects, even if the business was successful in amending its Constitution to increase the scope of its objects to include above-rail freight services, there are a number of operational impediments. For example, Queensland Rail does not have the capability or rolling stock necessary to operate these services. Queensland Rail would require significant lead time in order to undertake all of the necessary preparatory activities, which amongst other things could include, purchasing rolling stock, obtaining relevant approvals and accreditation, establishing operations and yard facilities, employing suitability qualified and experience staff and contractors, negotiating and executing haulage contracts (in competition with established operators) and arranging associated administrative requirements. The time required to implement these arrangements would likely extend beyond the regulatory period proposed in AU1.

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<sup>1</sup> Queensland Rail's Shareholding Ministers are currently Minister for Finance, Natural Resources and the Arts and Minister for Transport and Multicultural Affairs.

### *1.3.2 No material likelihood of a competing provider of passenger services*

There is currently no competing above-rail passenger services operating in Queensland in either the metropolitan or long-distance systems. Queensland Rail provides metropolitan and long-distance passenger services via transport services contracts (TSCs) negotiated between the business and the Queensland Department of Transport and Main Roads. While there are some passenger services provided by third-party providers, including Savannahlander, which operates between Cairns and Forsyth, this service does not directly compete with any of Queensland Rail's existing services.

There also is no significant likelihood of a competing third-party passenger services emerging in the future. This is due to the loss-making character of passenger services and their reliance on significant government support (e.g. via TSC payments). Accordingly the emergence of a third-party passenger operator would be contingent on the operator securing government support and, particularly in respect to the metropolitan network, this would require a significant policy change by the Queensland Government.

### *1.3.3 Major access parameters for passenger service access are subject to external control*

The principal parameters of Queensland Rail's use of its own railway network by its passenger services, with respect to train paths and timetables, are determined outside the access undertaking process. Indeed, Queensland Rail's metropolitan and long-distance passenger train paths and timetables are either priority reserved or preserved by the Department of Transport and Main Road (DTMR) through the TIA.

Under the TIA, Section 266, amongst other matters:

- allows for the Chief Executive (the Director General of DTMR) to identify passenger services requirements for regularly scheduled passenger services (Sections 266 (1) to (3));
- after a railway manager is notified of those passenger service requirements, the railway manager must, when a train path is available to allocate, give priority to the passenger service requirements (Section 266 (4)); and
- in certain instances, the Chief Executive may require a train path that is or will become available to be allocated to a stated passenger service (Section 266 (5C)).

This process of identifying and giving priority to regularly passenger services occurs outside the formal access undertaking process and decision making responsibility for this resides with the Chief Executive, rather than Queensland Rail.

In addition, section 266A of the TIA identifies "preserved train paths" in respect of regularly scheduled passenger services and effectively prevents these train paths from being allocated to non-passenger services, unless agreed to by the Chief Executive (Section 266A (2) and (3)).

With the allocation and preservation of passenger services occurring outside the access undertaking process, the allocation of capacity is reflective of the Government's public transport objectives, rather an exercise of market power by Queensland Rail.

### *1.3.4 Costly to administer*

A requirement for the Queensland Rail's passenger services to gain access through the formal access undertaking process, including the negotiation of internal access agreements, would impose significant administrative costs on the business.

Where (internal) access agreement have been required by the business in the past this required the establishment of separate contract managers and legal advisers for the above-rail and below-rail teams respectively, to negotiate arrangements. The regulatory arrangements also created significant costs associated with the on-going maintenance of these contracts. For example, where changes to passenger timetables were required (e.g. associated with operating additional services during significant events, such as New Years Eve or sporting events), it was necessary for the above and below-rail teams to negotiate a contract variation. In some years as many as 400 variations were required to be negotiated and agreed.

There also are systems which must be maintained to facilitate (internal) access agreement, such as maintaining a billing system to enable the below-rail business to levy access charges to the above-rail passenger services team.

While there may have been clear competitive grounds for requiring QR Limited's above-rail businesses to negotiate access in accordance with the access undertaking, particularly in respect to its above-rail freight services, this is no longer the case. Queensland Rail does not operate above-rail freight services and it is unlikely that a competing third-party above-rail passenger operator will emerge in the future. Accordingly, the potential competitive benefits from applying the formal access undertaking process to Queensland Rail's passenger services is unlikely to outweigh the administrative costs of regulatory compliance.

### *1.3.5 Precedent in other jurisdictions*

The approach proposed by Queensland Rail with respect to its passenger services is consistent with similar rail business in other Australian states.

For example, Metro Trains Melbourne (MTM), which is responsible for operating the below-rail infrastructure for the metropolitan network, along with providing above-rail metropolitan passenger services in Melbourne, is not required to enter into access agreements through its access undertaking for passenger services. This process instead is managed outside the formal access undertaking process.

Indeed, MTM's Franchise Agreement is administered by the Victorian Department of Transport, and provides for access rights to passenger services, with passenger service timetables and service standards determined by the Director of Public Transport. An access agreement, under MTM's Access Arrangement, is therefore only required for access by freight operators and MTM would only be required to enter into (internal) access agreements if it commenced above-rail freight services.

This is also similar to the arrangements for RailCorp in New South Wales (NSW), which provides passenger services through CityRail and access to the below-rail network. While the NSW Rail Access Undertaking, under which RailCorp provides access to its network, does not include specific provisions regarding access agreement for passenger services, in practice access arrangements for CityRail are negotiated outside the formal access undertaking process. Accordingly, it is not necessary for the RailCorp's passenger services to negotiate internal access agreements.

## 1.4 Fair treatment of third-party access holders

Where a business has assets which are shared across a number of different users, such as below-rail infrastructure used by both passenger and coal and bulk freight operators, it is necessary to be able to demonstrate that costs are managed and allocated appropriately. This is to ensure that some services/customers are not cross-subsidising other services/customers.

As Queensland Rail operates a network which services both passenger services and third-party coal and freight operators, it has developed a Costing Manual which details the approach for determining the below-rail cost base, and further identifying:

- below-rail costs attributable directly to specified line sections;
- below-rail costs not attributable to specified line sections but attributable to specified geographic regions; and
- below-rail costs not attributable to specified line sections or geographic region; and the methodology for allocating these costs to regions.

The boundaries of geographic regions have been developed to generally reflect changes in predominant traffic type, including urban passenger, bulk coal, and containerised freight. However, this is not intended to be related to operator or individual services.

Where the allocation of capacity is provided under different terms and conditions, such as the proposed arrangements for Queensland Rail's passenger services, this can create potential or perceived conflicts regarding fair treatment. This is particularly important for many freight operators moving product to port, where train delays or cancellations can lead to down-stream costs (e.g. demurrage costs).

Queensland Rail's Network Management Principles (NMP) are designed to ensure that operators are treated consistently and transparently in respect of scheduling and on the day of operations. These Principles apply to both Queensland Rail and third-party operators. The NMP includes requirements applicable to the Master Train Plan (MTP) which details the scheduled times for all Train Services and any planned possessions and the Daily Train Plan (DTP) which details the scheduled times for all Train Services operating and any planned, urgent or emergency possessions on a particular day.

Under the NMP, Queensland Rail may modify the MTP, schedule a DTP in variation from the MTP or modify a DTP once it is scheduled in certain circumstances. Generally, where such modifications or variations would result in an access holder's train services not being met, Queensland Rail must either consult with the access holder or seek the agreement of the access holder, subject to certain exceptions – for example, where an Emergency Possession is required after the DTP is scheduled.

In addition to the NMP, Queensland Rail is required to operate in accordance with the Passenger Priority Obligation specified in Section 265 of the TIA. It states that a railway manager must endeavour to bring a passenger service that is delayed back to its scheduled running time, taking into consideration any matters that the railway manager considers relevant.

## 1.5 Conclusion

Queensland Rail's proposed arrangements with respect to the treatment of the business' passenger services are appropriate in light of the current structure and operations of Queensland Rail.

While there may have been clear competitive grounds for requiring QR Limited's above-rail businesses to negotiate access in accordance with the access undertaking, particularly in respect to its above-rail freight services, this is no longer the case. Queensland Rail does not operate above-rail freight services and in the absence of a third-party competitor, the potential competitive benefits from applying the formal access undertaking process to passenger services is unlikely to outweigh the administrative costs of regulatory compliance. The proposed approach is also consistent with the treatment of passenger services for similar rail businesses in Victoria and NSW.

## **Attachment 2: PWC Supporting Analysis – Ringfencing Arrangements**

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# *Queensland Rail*

## Ringfencing arrangements

*Queensland Rail*

*Supporting analysis for  
submission to the QCA*

*27 March 2012*



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# 1 Introduction

## 1.1 Background

Queensland Rail commenced business independently from the QR National corporate group on 1 July 2010. Queensland Rail's primary business is the delivery of public transport through the provision of passenger rail services and supporting private freight services through the provision of rail infrastructure.

Since 1 July 2010, Queensland Rail has provided access to its below rail network under QR Network's 2008 Access Undertaking (as at 30 June 2010) to the extent that it was made to apply to Queensland Rail by a transfer notice and project direction (Transfer Notice) dated 29 June 2010 under the *Infrastructure Investment (Asset Restructuring and Disposal) Act 2009* (Qld) (Temporary Undertaking).

In light of the new structure of the business and the approaching expiry of the Temporary Undertaking, Queensland Rail is preparing a draft access undertaking (Queensland Rail Access Undertaking 1 (AU1)) to submit to the Queensland Competition Authority (QCA). AU1 seeks to provide an access undertaking that better suits the operations and requirements of Queensland Rail, whilst preserving the basic process for access seekers to negotiate access terms, and that simplifies the Temporary Undertaking to be better understood by all parties.

## 1.2 Purpose and approach

Under AU1, Queensland Rail is proposing changes to the ringfencing arrangements of the Temporary Undertaking, adopting a less prescriptive approach. This approach seeks to limit the tangible and intangible costs incurred in complying with ringfencing obligations and is a response to the diminished benefits of stringent ringfencing given changes to the business structure.

The purpose of this paper is to present justification for a more light-handed approach to ringfencing in view of the recent corporate restructure of Queensland Rail, having regard to:

- the nature of Queensland Rail's business; and
- consistency of the proposed arrangements with the ringfencing requirements imposed on similar rail businesses in other Australian jurisdictions.

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## 2 Ringfencing

### 2.1 What is ringfencing?

Ringfencing refers to the separation of component activities of a vertically integrated business. Ringfencing commonly forms part of the regulatory framework for a business where a part of the business provides a monopoly service to itself and to competing third-party business for the purposes of providing contestable services. This is the case where a vertically integrated rail business provides below-rail services (the monopoly service) both for its own train services as well as competing providers of train services (the contestable services).

Ringfencing requirements are commonly imposed as an element of regulation to reduce the potential for anticompetitive behaviour of the vertically integrated business that may arise from:

- the business providing the monopoly service to other third-party businesses on unfavourable terms so as to limit the ability of these other businesses to compete; and
- the business providing the monopoly service having access to commercial information from the other businesses (such as information on end customers) that it can use for competitive advantage.

Ringfencing requirements are applied with the objective of establishing transparency in the terms of provision of the monopoly service to both internal and competing users of the service and to limit potential for the service provider to gain a competitive advantage through access to commercial information of competitors. Requirements can include some or all of the following:

- *Legal separation* – a requirement for the monopoly service to be provided by a legally-separate entity.
- *Ownership separation* – prohibition of a business providing the monopoly service from also providing the contestable service.
- *Management separation* – restrictions on personnel having management roles across both monopoly and contestable services.
- *Accounting separation* – requirement for the separate financial accounts to be maintained for the parts of the business providing monopoly and contestable services.
- *Restriction on information flows* – Protocols and restrictions for the handling of information relating to competing users of the monopoly service and their customers.

## 2.2 Determining the appropriate level of ringfencing requirements

The extent and scope of ringfencing requirements depends greatly on the nature of the industry, regulatory requirements and the organisational structure of the business. Ringfencing arrangements should seek to balance competitive benefits against compliance costs for the regulated entity. Indeed, as acknowledged by the QCA:

*'while ringfencing can provide benefits in terms of removing potential barriers to competition, it also imposes costs. In particular, it constrains the commercial behaviour of a firm by requiring particular forms of conduct. As such, it is an inherently intrusive activity. Monitoring compliance with ring-fencing arrangements will mean the regulator will require ongoing information about the business'.<sup>1</sup>*

The degree of prescription in the form of regulation, including how it applies to ringfencing, is typically related to the structure of industry, the degree of market power and the scope for enhancement in competition over time.

For example, a vertically integrated business with significant market power may require a more heavy-handed approach to regulation and ringfencing. A good example of this was the formerly integrated electricity distribution and retail businesses in Queensland, Energex and Ergon. With the introduction of retail competition, these businesses were both vertically and horizontally integrated in the network and retail levels of the industry.

The QCA developed detailed and prescriptive accounting and operational separation rules, which required electricity distribution businesses to be legally separate entities and operate at arm's length from the commonly-owned downstream retail service provider.<sup>2</sup> This included requirements for accounting separation and the requirement that marketing staff involved in the distribution business are not involved in any other business.<sup>3</sup> Energex also established separate Boards, CEOs, management teams and office for the retailing and distribution arms of the business.

The Australian Energy Regulator (AER), which from 1 July 2010 became responsible for ringfencing compliance of participating jurisdictions in accordance with the guidelines developed by the respective jurisdictional regulators, is currently reviewing the appropriateness of these ringfencing guidelines. As part of this review the AER is assessing a range of factors including whether changes to the structure of the National Energy Market mean that ringfencing guidelines are no longer necessary.<sup>4</sup>

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<sup>1</sup> Queensland Competition Authority. 2000. *Electricity distribution: ring-fencing guidelines*. September 2000. Pg. 8

<sup>2</sup> Queensland Competition Authority. 2000. *Electricity distribution: ring-fencing guidelines*. September 2000. Pg. 20

<sup>3</sup> Queensland Competition Authority. 2000. *Electricity distribution: ring-fencing guidelines*. September 2000. Pg. 20

<sup>4</sup> Australian Energy Regulator. 2011. *Electricity Distribution Ring Fencing Guidelines Review: Discussion Paper*. December 2011. Pg. 19-20

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## 3 Temporary and proposed undertaking

### 3.1 Previous ringfencing arrangements

In 2008 QR Limited undertook a corporate restructure to facilitate the separation of the business' rail infrastructure management from the operation of train services. This included the creation of QR Network Pty Ltd (QR Network), responsible for managing the provision of below-rail services, as a subsidiary of QR Limited and separate from the other QR Limited Operational Business Groups.

As part of that restructure, QR Network's 2008 Access Undertaking (2008AU) was approved by the QCA and QR Limited's access undertaking was withdrawn. QR Network's 2008AU included detailed ringfencing arrangements, including obligations and procedures governing the treatment and disclosure of access seeker/holder confidential information. These arrangements were based on the former structure of the business, and sought to minimise the potential for anti-competitive outcomes that may otherwise be enabled by the vertically-integrated nature of the business.

The ringfencing provisions in the 2008AU specify the following requirements:

- Responsibilities for the different business groups (subsidiaries) and the process for adjusting the business structure (e.g. such as winding up the operations of QR Network, or assigning any below rail functions to another part of the business) (Clause 3.1).
- Requirements for the appropriate treatment of confidential information (Clause 3.3), including provisions regarding the external and internal flows of confidential information, including with respect to:
  - External flows of confidential information – QR Network will avoid a conflict of interest by, for instance, avoiding the appointment of an external advisor/consultant where the same advisor is providing services to the Queensland Rail operational business groups.
  - Internal flows of confidential information – Confidential information may be disclosed to some of the executives, the board and the support staff of the respective entities. With approval from the access seeker/holder, confidential information may be passed on to Queensland Rail services in the areas of property and/or engineering and to QR Services employees in management levels 2, 3 and 4 in relation to Rail Infrastructure issues. A ringfencing register is required to be established to assist in monitoring the flow of information and the parties involved.
- Principles regarding decision making by QR Network when making decisions that could materially or adversely affect a third party access holder/seeker (Clause 3.4). The principles include requirements to ensure that the decision is made by an identified decision maker, the decision is made in a manner that is consistent between access seekers/holders in the same circumstances and either that the decision was required to comply with law, direction by the QCA, QR Network's policies and procedures or the reasons for the decision are documented by QR Network.
- Obligations regarding compliance and enforcement (Clause 3.5), including requirements to notify the QCA when an access seeker/holder lodges a complaint in relation to ringfencing obligations in writing to QR Network,

requirements for the initiation of an investigation, and requirements to audit how confidential information and decision making is treated.

- Requirements for accounting separation (Clause 3.2), including the preparation of financial statements (either consolidated financial statements from QR Network or audited general purpose financial statements) in accordance with the Costing Manual (as approved by the QCA from time to time), which includes:
  - the process for identifying, from QR's audited general purpose financial statements, the cost base for Below Rail Services, separate from other services provided by QR or Related Parties of QR to which those "Financial Statements" relate; and
  - within the cost base for "Below Rail Services", the process for identifying costs attributable to specified line sections (line section costs), costs not attributable to specified line sections but attributable to specified geographic regions (regional costs), and costs not attributable to specified line sections or any specified geographic region (network costs); and
  - the format of "Financial Statements".

Queensland Rail is currently providing access in accordance with the Temporary Undertaking, via the Transfer Notice dated 29 June 2010. Under the Transfer Notice, Clauses 3.1 (relating to organisation structure) and Clause 3.3 (relating to the management of confidential information) of the 2008AU do not apply to Queensland Rail. The ringfencing provisions, which include provisions regarding accounting separation, the preparation of financial statements, decision making and compliance and enforcement, continue to apply to Queensland Rail.

The Transfer Notice also specifies confidentiality requirements with which Queensland Rail is required to comply to protect the confidentiality of information disclosed by access seekers and access holders for the purpose of negotiating an access agreement or under an access agreement.

## 3.2 Proposed AU1

Under the proposed AU1, detailed ringfencing requirements on the business have not been included.

However, Queensland Rail will maintain separate accounting records in a form approved by QCA for the declared service and in accordance with section 163 of the *Queensland Competition Authority Act 1997* (QCA Act). AU1 also includes provisions for the treatment of confidential information (Clause 2.2). A full extract of the confidentiality provisions of AU1 is provided in Appendix A.

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## 4 Justification for a lower level of ringfencing requirements

### 4.1 The costs of stringent ringfencing requirements are not warranted

While ringfencing may provide benefits in terms of addressing potential barriers to competition, it also imposes costs. This can include generating administrative costs for the business associated with duplicating systems and personnel and constraining the commercial behaviour of the business by requiring particular forms of conduct.

For example, the ringfencing arrangements under the Temporary Undertaking were based on legal separation, accounting separation and restricted information flows. The introduction of similar arrangements in Queensland Rail would generate substantial and tangible costs for the business, such as accounting and information technology system duplication, with the need for Queensland Rail's below rail activities to have separate systems from the rest of the business. This could also require physical separation of the access team from the business' other functions and the requirement for appropriate security arrangements regarding physical access between the different parts of the business.

Stringent ringfencing could lead to duplication of management and staff, such as requiring separate support staff, management staff or even a separate Board to oversee the business activities as they relate to the below rail activities of the business. Such requirements would create significant additional staffing costs for the business.

Highly prescriptive ringfencing requirements may also slow decision making. Where unnecessary constraints on information flows are imposed, particularly for Queensland Rail's management this may limit opportunities for cooperation between management personnel and impede the ability of the business to operate as a flexible, dynamic and integrated organisation.

Certain aspects of ringfencing may also impose monitoring and compliance requirements, compelling the business to provide on-going information regarding the operations of the business to the regulator. Further, the imposition of redundant ringfencing arrangements may also generate administrative costs for the business associated with meeting these requirements, or applying to the regulator for waivers regarding ringfencing conditions that may be inappropriate for the business.

In considering the extent of ringfencing requirements, it is necessary to balance the potential for administrative costs and disruption to the business against the expected competition benefits.

The ringfencing arrangements that previously applied to QR Limited, which operated above-rail freight services, and which have been expanded for QR Network were intended to address the potential for that business to prevent or

hinder access<sup>5</sup> to competing third party access seekers to benefit its own (or related party) above rail freight operations.

Queensland Rail, however, is a vertically-integrated *passenger* business. The business does not directly compete with third-parties as an operator of either passenger or freight train services and is not realistically likely to do so during the proposed term of AU1. In particular, Queensland Rail can only undertake activities within the scope of its objects defined by the business' constitution. The business also does not currently compete with any third-party passenger services and there is no material likelihood of a competing provider of passenger services emerging due to the lack of commercial profitability of these types of services and their reliance of government support via transport service contracts.

This substantive change to the nature and structure of the business means there is no incentive for the business to use its market power to limit competition in related markets. Highly prescriptive ringfencing requirements would impose significant costs with very little benefit to users and the State in terms of enhanced potential for competition.

While acknowledging the significant differences in objectives and structure of the current Queensland Rail, as the business operating a network which services both above rail passenger services and third-party below rail freight operators, the business will retain some aspects of ringfencing. These proposed arrangements tailor the ringfencing requirements in accordance with essential elements of transparency with respect to costs and accounting and the handling of commercially sensitive information.

## 4.2 Consistency with ringfencing arrangements in other jurisdictions

The ringfencing arrangements proposed by Queensland Rail are also consistent with similar rail business in other Australian states.

For example, in Victoria, *Ring Fencing Rules* (the Rules) have been developed under the Victorian Rail Access Regime (VRAR), in accordance with the Victorian *Rail Management Act 1996* (RMA). However, while the Rules are in place they have not been applied to any Victorian access provider as there is currently little vertical integration in the Victorian rail industry.<sup>6</sup>

Metro Train Melbourne (MTM) and V/Line, which are responsible for the operating below rail infrastructure for the metropolitan network and regional networks respectively, along with the provision passenger services, however are still subject to some ringfencing requirements. For instance, MTM's access arrangement includes requirements for Information Handling Protocols. Further, at the commencement of V/Line's access arrangement, the Essential Services Commission (the Commission) decided that ringfencing rules would not apply to V/Line. However, the Commission is able to impose ringfencing obligations after the Commencement Date of the access arrangement, but has not done so to date.

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<sup>5</sup> Where this includes sharing commercial information regarding access seekers with other QR business units, or imposing access charges or access conditions which disadvantage competing third party operators.

<sup>6</sup> Essential Services Commission. 2010. *Review of the Victorian Rail Access Regime Final Report: Volume II: Detailed Analysis and Discussion of Issues*. February 2010. Pg. 93

In New South Wales (NSW), there are no legislative requirements regarding ringfencing obligations. However, while RailCorp's access undertaking does not include specific ringfencing arrangements, it does impose requirements for the separation of business accounts.

Finally, in Western Australia, ringfencing arrangements<sup>7</sup> are required under the Western Australian *Railways (Access) Act 1998*. The ringfencing requirements under the Act include:

- protection of confidential information;
- avoidance of conflict of interest;
- duty of fairness; and
- maintenance of separate accounts and records.

The former Western Australian Government Railways Commission (WAGR), now under the control of the Public Transport Authority, is responsible for the provision of urban passenger and also access to the below rail suburban network. While ringfencing obligations still apply to WAGR, these were less restrictive than arrangements which apply to other vertically integrated rail businesses, such as the former WestNet Rail (now Brookfield Rail). In determining the appropriate ringfencing arrangements for the former WAGR, the regulator acknowledged:

- a one-size-fits-all approach to segregation rules, while simpler, may impose undue compliance costs on WAGR, without any likelihood of encouraging other operators to enter the urban passenger transport market; and
- WAGR has a different business focus, and it is unlikely that an operator will enter the Western Australian rail passenger market in the foreseeable future.<sup>8</sup>

Further details regarding the ringfencing requirement for rail businesses in Victoria, NSW and Western Australia is provided in Appendix B.

## 4.3 Conclusion

Queensland Rail's proposed arrangements with respect to ringfencing are appropriate based on the current structure and operations of Queensland Rail. The business does not directly compete with third-parties as an operator of either passenger or freight train services and is not realistically likely to do so during the proposed term of AU1. Accordingly, highly prescriptive ringfencing requirements, similar to those previously imposed on QR Limited and which have been expanded for QR Network, would not be warranted; such arrangements would impose significant costs with no benefit in terms of increased competition.

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<sup>7</sup> In Western Australia, ringfencing is referred to as segregation. Section 28 of the *Railways (Access) Act 1998* includes requirements for railway owners to make arrangements to segregate its access-related function from its other functions.

<sup>8</sup> Office of the Rail Access Regulator. 2002. *Segregation arrangements to apply to the Western Australian Government Railways Commission: Determination of the Western Australian Independent Rail Access Regulator*. 6 June 2002. Pg. 9.

However, some elements of ringfencing will continue to apply to Queensland Rail including preparing separate accounting records in accordance with the QCA Act, and provisions in AU1 which detail requirements for the treatment of confidential information. These arrangements are also consistent with the arrangements in place for similar rail business in Victoria, NSW and Western Australia.

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## Appendix A AU1 Confidentiality provisions

### 2.2 Confidentiality

#### 2.2.1 Obligation to keep Confidential Information confidential

- (a) Subject to clause **2.2.1(b)**, Queensland Rail and each Access Seeker (by submitting an Access Application) acknowledge, as a Recipient, that Confidential Information disclosed to it must:
  - (i) be treated as and kept confidential;
  - (ii) only be used for the purpose for which it was disclosed;
  - (iii) be treated as the property of the Disclosing Party; and
  - (iv) only be disclosed in accordance with this Undertaking or a confidentiality agreement between the parties.
- (b) A Recipient of Confidential Information is not required to comply with clause **2.2.1(a)** in relation to a disclosure or use of Confidential Information to the extent that:
  - (i) the Disclosing Party has given its written consent (which must not be unreasonably withheld) to that disclosure or use; or
  - (ii) another Confidentiality Exception applies to that disclosure or use.

#### 2.2.2 Requirement for confidentiality agreement

- (a) Either of Queensland Rail or the relevant Access Seeker may require the other to enter into a confidentiality agreement and, if so, the parties must act reasonably and promptly to negotiate and execute such an agreement.
- (b) Neither Queensland Rail nor an Access Seeker is obliged to disclose Confidential Information to the other unless a confidentiality agreement on terms satisfactory to it (acting reasonably) has been executed.

#### 2.2.3 Responsibility for disclosure

If a Recipient of Confidential Information discloses all or part of that Confidential Information to:

- (a) the directors, company secretary, officers or employees of the Recipient or a Related Party of the Recipient; or
- (b) the Recipient's solicitors, barristers, accountants, technical consultants or other advisers;

under a Confidentiality Exception, then the Recipient:

- (c) must use its best endeavours to ensure that person keeps the Confidential Information confidential; and
- (d) is responsible for the actions and omissions of that person in relation to the Confidential Information as though those actions and omissions were the Recipient's.

## Definitions

**Confidential Information** means any information, data or other matter (in this definition, information) disclosed to a Recipient by, or on behalf of, a Disclosing Party where:

- (a) the Recipient knows or ought to know that the information is confidential;
- (b) the information is by its nature confidential; or
- (c) at the time of the disclosure to the Recipient, the information is marked or otherwise indicated as confidential when disclosed,

excluding information that:

- (d) was in the Recipient's lawful possession prior to the disclosure; or
- (e) whether before or after the disclosure:
  - (i) is in the public domain through means other than a breach of confidentiality by the Recipient (or anyone to whom the Recipient has disclosed it); or
  - (ii) is received by the Recipient independently from a third party who is free to disclose such information;

**Confidentiality Exception** means:

- (a) any disclosure or use of Confidential Information consented to by the Disclosing Party under clause 2.2.1(b)(i); or
- (b) any disclosure or use of Confidential Information:
  - (i) to the extent necessary to:
    - (A) the Recipient's directors, officers or employees; or
    - (B) the directors, officers or employees of a Related Party of the Recipient;
  - (ii) to the extent required or compelled by any Law;
  - (iii) to the extent necessary for the conduct of any legal proceedings (including any dispute resolution process under this Undertaking or the QCA Act);
  - (iv) to the extent required under any stock exchange listing requirement or rule;
  - (v) to the Rail Safety Regulator or the QCA;
  - (vi) to the Recipient's solicitors, barristers, or accountants under a duty of confidentiality (which is not waived by the Recipient without the prior written consent of the Disclosing Party);
  - (vii) to the Recipient's engineering or other technical consultants and advisers to the extent necessary for the provision of advice to the Recipient (provided they are under a legal obligation not to disclose the Confidential Information to any third party);
  - (viii) to the Recipient's banker, financier or other financial institution, to the extent required for the purpose of raising funds or maintaining

compliance with credit arrangements, if such banker or financial institution has executed a legally enforceable confidentiality deed in favour of the Disclosing Party under which they are obliged to keep the Confidential Information confidential;

- (ix) if Queensland Rail is the Recipient, to the shareholding Ministers (as defined in the *Government Owned Corporations Act 1993* (Qld)) of Queensland Rail;
- (x) for the purpose of facilitating Train Control Directions where the disclosure of information is by Queensland Rail in the usual course of undertaking Train Control; or
- (xi) by any person involved in clearing an incident or emergency that is preventing or affecting the operation of Train Services on the Network;

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## Appendix B Ringfencing provisions of other Australian below rail businesses

### Victoria

The Essential Services Commission (the Commission) is the regulator of the Victorian rail industry under the *Rail Management Act 1996* (RMA).<sup>9</sup> Part 2A of the RMA establishes the *Victorian Rail Access Regime* (VRAR), which came into effect in 1 January 2006.<sup>10</sup>

The RMA contains specific provisions relating to the role of the Commission in establishing ringfencing rules, including Section 38S that states:

*The Commission must make rules for or with respect to-*

- (a) *requiring an access provider to separate its access activities from its other activities as if the access activities are being carried out by a different entity; and*
- (b) *the manner in which the access provider is to effect the separation of its access activities from its other activities as provided for by paragraph (a); and*
- (c) *requiring an access provider that provides declared rail transport services to itself or related bodies corporate, to provide those services on an arm's length basis.*

The Commission has also developed the VRAR *Ring Fencing Rules* (the Rules) in accordance with RMA to facilitate competitively neutral access to regulated-below rail services. The Rules allow for the Commission to require an access provider to:

- (a) *establish an internal organisational structure in which the business unit responsible for providing regulated below rail services is separate from the access provider's above rail business and other activities; and*
- (b) *ensure that the below rail business unit conducts its business activities at arm's length to the above rail businesses, including with respect to the provision of services to the above rail businesses.*

The Rules specify ringfencing obligations in respect of:

- the separation of access activities from other activities
- the provision of declared rail transport services by an access provider to itself or a related body corporate
- the establishment and maintenance of policies, procedures and systems to ensure compliance with the Rules

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<sup>9</sup> The *Rail Corporations Act 1996* was changed to the *Rail Management Act 1996* by section 200(1) of the *Transport Integration Act 2010*.

<sup>10</sup> Essential Services Commission 2010, *Review of the Victorian Rail Access Regime Final Report: Volume I Findings and Recommendations*, February.

- the manner in which separation of access activities from other activities is to be effected.

In February 2010, the Commission, under instruction from the Minister for Finance, conducted an independent review into the effectiveness and applicability of VRAR considering the current and likely future structure of the industry.

In this review the Commission acknowledged that while the Rules are in place, they have not been applied to any access providers as there is currently little vertical integration in the Victorian rail industry. The Commission considered that the regime could include a statutory requirement for access providers to maintain separate accounting records for access activities, and provide the ability for the Commission to make Ring Fencing Rules, but need not make the establishment of those rules mandatory.<sup>11</sup>

The Commission recommended that:

*The current statutory requirement for the Commission to issue Account Keeping Rules and Ring Fencing Rules should be replaced by:*

- *statutory obligations for access providers to maintain separate accounting records for access activities*
- *an ability for the Commission to make record keeping guidelines including specifying appropriate cost allocation principles and the form of annual regulatory accounts (or Ring Fencing Rules if an access provider were to become a vertically integrated freight rail operator), and*
- *statutory obligations for access providers to provide financial records to the Commission in accordance with the Guideline.*

To date there has been no formal response by the Victorian Government to the review's findings and recommendations.

The application of ringfencing arrangements to V/Line and Metro Train Melbourne (MTM) is summarised in Table 1 below. V/Line is the below rail provider for the Victoria regional network, which also operates regional passenger services, while MTM is the below-rail access provider for the Victorian metropolitan rail network, which also operates above rail passengers services.

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<sup>11</sup> Essential Services Commission. 2010. *Review of the Victorian Rail Access Regime Final Report: Volume II Analysis and Discussion of Issues*. February 2010. pg. 93

**Table 1 – Ringfencing arrangements by rail businesses in Victoria**

<b>Rail Entity</b>	<b>Ringfencing provision</b>
<b>V/Line (Vic)</b>	<p>At the commencement date of V/Line's access arrangement, the Commission decided that the ringfencing rules would not apply to V/Line. However, Part 8 of the access agreement includes provisions regarding the treatment of access seeker information, training for staff regarding ringfencing and a dispute resolution process where the business does comply with the V/Line's obligations under the RMA regarding confidential information.</p> <p>The Commission is also able to impose ringfencing obligations on the V/Line after the Commencement Date of the access arrangement (Subclause 8.1.b, Part 8), but has not done so.</p>
<b>Metro Trains Melbourne (Vic)</b>	<p>MTM's 2011 access arrangement does not include provisions relating specifically to ringfencing arrangements.</p> <p>Clause 4.2 requires that any proposed variation to access arrangements should be consistent with account keeping rules, ringfencing rules and other associated rules and guidelines. However, there are no specific rules regarding ringfencing specified in the access arrangements.</p> <p>While the access arrangement does not include specific requirement regarding ringfencing, Attachment H of MTM's 2011 access arrangement contains an Information Handling Protocol.</p> <p>The Information Handling Protocol, developed in accordance with the requirements of the RMA and VRAR instruments, describes the system and business rules regarding the use and disclosure of confidential information (Clause 4.2 and 4.3)</p>

## *New South Wales*

Schedule 6AA of the *Transport Administration Act 1988* (NSW) provides for a rail infrastructure owner in New South Wales to establish an access undertaking, subject to the approval of the relevant Minister according to a broad criterion of the "public benefit" of the undertaking..

The Act does not include specific requirements for ringfencing.

RailCorp is owned by the NSW Government and operates passenger rail services throughout the Sydney metropolitan, outer-urban, and regional areas. RailCorp also owns and maintains the metropolitan rail network and provide access to freight operators in the area and is regulated by IPART.

RailCorp's Access undertaking does not include specific ringfencing arrangements. However, it does impose requirements for the separation of business accounts. For example, clause 7.5 stipulates the need to maintain separate business accounts for any elements of the business which do not relate to:

- (a) *The holding, management and establishment of the NSW Rail Network for Rail Operations; or*
- (b) *The provision of access pursuant to this Access Undertaking.*

## *Western Australia*

The Rail Access Regime in Western Australia comprises the *Railways (Access) Act 1998* and the *Railways (Access) Code 2000*. The *Railways (Access) Act 1998* was enacted to establish a rail access regime that would encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations within Western Australia. The Act confers on the regulator, currently the Economic Regulation Authority, monitoring, enforcement and administration functions for the implementation of the Rail Access Regime. The development of the *Railways (Access) Code 2000* was a requirement of the Act.

Section 28 of the *Railways (Access) Act 1998* requires that railway owners to make arrangements to segregate (ringfence) its access-related functions from its other functions and to have appropriate controls and procedures to ensure that the arrangements in place operate effectively and are being complied with. Further under Section 29 of the Act, these arrangements must be approved by the regulator.

The *Railways (Access) Act 1998* also detailed those matters to be covered as part of a duty to segregate, and include:

- protection of confidential information – to protect access seeker’s confidential information and prevent its improper use or disclosure (Section 31);
- avoidance of conflict of interest – to ensure no conflicts in duties between the performance of access-related functions and other business activities by the rail owner (Section 32);
- duty of fairness – to ensure that officers must not have regard to the interests of the railway owner in a way that is unfair to access seekers or other rail operators (Section 33); and
- maintenance of separate accounts and records – to ensure that all accounts and records regarding access related functions are properly recorded and distinguished from the railway owner’s other accounts and records (Section 34).

In Western Australia, the former Western Australian Government Railways Commission (WAGR), now under the control of the Public Transport Authority, was responsible for the provision of urban passenger services. The business was also the railway owner for the Western Australian suburban rail infrastructure and had management and control over the use of that railway infrastructure.

In 2002, in accordance with Section 28 of the *Railways (Access) Act 1998*, the then WAGR submitted its proposed segregation rules to the regulator.

In considering WAGR proposed segregation rules, the regulator acknowledged:

- a one-size-fits-all approach to segregation rules which applies to other rail infrastructure providers, such as WestNet Rail, now Brookfield Rail,<sup>12</sup> while simpler, may impose undue compliance costs on WAGR, without any likelihood

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<sup>12</sup> WestNet Rail, now Brookfield Rail, is the railway owner of around 5,000 kilometres of track in the south-west of Western Australia. In accordance with the Rail (Access) Code 2000, certain parts of WestNet’s rail network are to be made available for access by third party rail operators.

of encouraging other operators to enter the urban passenger transport market;<sup>13</sup>

- WAGR has a different business focus, and it is unlikely that an operator will enter the rail passenger market in the foreseeable future.<sup>14</sup>

The regulator, while determining that some segmentation conditions were necessary to comply with the requirement under the Act, was more lenient regarding certain segmentation arrangements, including allowing for staff from rail operating divisions to be seconded to the network team, and not requiring the Network team to commit to being self sufficient for regulatory accounting, access pricing and revenue management.<sup>15</sup>

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<sup>13</sup> Office of the Rail Access Regulator. 2002. *Segregation arrangements to apply to the Western Australian Government Railways Commission: Determination of the Western Australian Independent Rail Access Regulator*. 6 June 2002. Pg. 8.

<sup>14</sup> Office of the Rail Access Regulator. 2002. *Segregation arrangements to apply to the Western Australian Government Railways Commission: Determination of the Western Australian Independent Rail Access Regulator*. 6 June 2002. Pg. 9.

<sup>15</sup> Office of the Rail Access Regulator. 2002. *Segregation arrangements to apply to the Western Australian Government Railways Commission: Determination of the Western Australian Independent Rail Access Regulator*. 6 June 2002. Pg. 7.

## **Attachment 3: PWC Supporting Analysis – Capacity Allocation**

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# *Queensland Rail*

## Capacity allocation

*Queensland Rail*

*Supporting analysis for  
submission to the QCA*

*28 March 2012*



*What would  
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# 1 Introduction

## 1.1 Background

Queensland Rail commenced business independently from the QR National corporate group on 1 July 2010. Queensland Rail's primary business is the delivery of public transport through the provision of passenger rail services and supporting private freight services through the provision of rail infrastructure.

Since 1 July 2010, Queensland Rail has provided access to its below rail network under QR Network Pty Ltd's (QR Network) 2008 Access Undertaking (as at 30 June 2010) to the extent that it was made to apply to Queensland Rail by a transfer notice and project direction (Transfer Notice) dated 29 June 2010 under the *Infrastructure Investment (Asset Restructuring and Disposal) Act 2009* (Qld) (Temporary Undertaking).

In light of the new structure of the business and the approaching expiry of the Temporary Undertaking, Queensland Rail is preparing a draft access undertaking (Queensland Rail Access Undertaking 1 (AU1)) to submit to the Queensland Competition Authority (QCA). AU1 seeks to provide an access undertaking that better suits the operations and requirements of Queensland Rail, whilst preserving the basic process for access seekers to negotiate access terms. AU1 also seeks to provide a simplified undertaking that can be better understood by all parties.

## 1.2 Purpose and approach

Under AU1, Queensland Rail has removed the queuing provisions of the Temporary Undertaking and replaced these provisions with a light-handed, principles-based approach to capacity allocation. This approach seeks to reduce the administrative processes of managing a formal queue, while still providing access seekers with guiding principles for how applications for competing access rights will be assessed.

The purpose of this paper is to review Queensland Rail's approach in AU1 having regard to:

- the nature of Queensland Rail's business;
- the likely impact the proposed approach will have on Queensland Rail and access seekers; and
- consistency of the proposed approach with mechanisms of capacity allocation applied by similar below rail providers.

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## 2 Current and proposed provisions for capacity allocation

### 2.1 Temporary Undertaking

#### 2.1.1 Background

Prior to 2008, QR Limited provided below and above rail services, including above rail freight operations. In 2008, the business was separated into a number of legally separate subsidiaries, including QR Network Pty Ltd (QR Network) which operated the below rail infrastructure, QR Passenger Pty Ltd (QR Passenger) which operated the passenger business and QR National which provided above rail freight and haulage services, particularly to Queensland coal mines. The business structure was implemented to facilitate the separation of the management of below rail assets from the operation of train services.

QR Network's 2008 Access Undertaking (2008AU) was approved by the QCA in 2008. The 2008AU was developed based on the structure of QR Network, and in light of the overall operations of QR Limited, which included the provision of above rail freight services.

Queensland Rail commenced business as a vertically integrated business, independent from the QR National corporate group on 1 July 2010. Since 1 July 2010, the business has provided access to its below rail network in accordance with the Temporary Undertaking. Many of the provisions of the 2008AU developed for QR Network, including the arrangements for capacity allocation, therefore have continued to apply to the business.<sup>1</sup>

#### 2.1.2 Capacity allocation provisions

Part 4 and Part 7 of the Temporary Undertaking include provisions for the allocation of capacity via a queuing mechanism.

The queuing mechanism is used as a method for managing negotiations for access when two or more parties seek mutually exclusive access rights.

Under Part 7, access rights will be allocated to the first access seeker with whom Queensland Rail can negotiate and execute an acceptable Access Agreement (clause 7.4.1(a)). However, where competing access applications are received, Queensland Rail is required to negotiate with each of the competing access seekers to see if any are willing to modify their requirements in order to allow all access applications to be accommodated (clause 7.4.1(c)).

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<sup>1</sup> The Transfer Notice, dated 29 June 2010, provides for the 2008AU to apply to Queensland Rail. However, the Transfer Notice has detailed specific provisions of the 2008AU which do not apply to Queensland Rail, such as clauses 2.2(d), 2.2(f) to (i), 2.5, 3.1 and 3.3.

If this is not possible:

- a queue will form when two or more access seekers seeking to negotiate mutually exclusive access rights notify Queensland Rail of their intention to progress their applications as outlined in clause 7.4.1(c)
- the initial order of the queue will be determined taking into account whether the application was made before, or after 30 June 2006. In particular, clause 7.4.1(d) states:
  - (i) *where the Access Application was lodged prior to 30 June 2006, application by [Queensland Rail] of the principles for allocation of capacity specified in Subclause 7.4.1 of the 2001 Undertaking (with the initial order of priority in the queue of such Access Applications being determined in accordance with how favourable each Access Application is in terms of the commercial performance of Below Rail Services such that, for example, the first queue position is given to the Access Application most favourable in terms of the commercial performance of Below Rail Services); and*
  - (ii) *where the Access Application was lodged on or after 30 June 2006, the date on which [Queensland Rail] received the relevant Access Applications, so that the Access Application received by [Queensland Rail] at the earliest time is first in the queue, and the Access Application received next by QR Network is second in the queue, and so on, provided that any such Access Applications will be placed after any Access Applications referred to in Subparagraph 7.4.1(d)(i).*

Once the queue is established Queensland Rail may change the order of the queue in accordance with the circumstance specified in clause 7.4.1(e) including, for example, where:

- Queensland Rail reasonably considers an access seeker has no genuine intention of obtaining access rights (clause 7.4.1(e)(ii));
- Queensland Rail reasonably considers the commercial performance of below-rail service (e.g. the net present value of the contribution to common costs) is better served by allocating access to an access seeker who is not necessarily first in the queue (clause 7.4.1(e)(iii));
- it is acting in accordance with specific principles contained in the Temporary Undertaking that relate to the allocation of capacity for two or more access applications of the same traffic type (clause 7.4.1(e)(iv)); or
- a new Access Application is added to the queue (clause 7.4.1(e)(v)).

Part 4 also includes provisions for how disputes, where parties are unable to determine mutually satisfactory outcomes, will be treated should any arise during the negotiation period (clause 4.5.2(i) and clause 4.7).

## 2.2 Proposed AU1

Part 2 of the proposed AU1 establishes the negotiation process for access seekers, including the provisions for access seekers competing for access rights.

Clause 2.7.2 of the proposed AU1 states:

(a) *If:*

- (i) two or more Access Seekers are seeking Access Rights; and*
- (ii) the grant of Access Rights to one or more of those Access Seekers would result in Access Rights not being able to be granted to the other Access Seekers,*

*then Queensland Rail will:*

- (iii) notify each of those Access Seekers as soon as practicable after it becomes aware of that circumstance; and*
- (iv) subject to clauses 2.7.2(b) and (c) and clause 2.7.3 enter into an Access Agreement with the Access Seeker who is ready and willing to execute an Access Agreement with Queensland Rail which, in the opinion of Queensland Rail (in its absolute discretion), is the most favourable to Queensland Rail based on:*
  - (A) the Access Charges that are expected to arise from the Access Agreement;*
  - (B) the cost and risk to Queensland Rail of providing Access Rights in accordance with the Access Agreement;*
  - (C) the ability of the Access Seeker to satisfy and to continue to satisfy the prudential requirements set out in clause 2.9.1;*
  - (D) the term of the Access Agreement; and*
  - (E) any other effects that entering into the Access Agreement may have on Queensland Rail's financial and risk position.*

The proposed capacity allocation provisions remove the requirement for the business to manage a formal queue, and associated administrative tasks, such as notifications to access seekers, adjustments to the queue following changes in the circumstances of access seekers, and providing justification regarding changes to the queue where requested by access seekers.

The proposed provisions also allow for the business to execute an access agreement with an access seeker that is most favourable to Queensland Rail, having regard to a number of factors, including the access charges which are expected to arise for the access agreement.

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## 3 Reasons and justification

Capacity allocation frameworks in access undertakings are designed to allocate scarce capacity amongst competing users. The overriding principle for capacity allocation is to provide access seekers with certainty regarding the process and criteria for the allocation of capacity, and ensure that all access seekers are treated fairly and in a non-discriminatory fashion. This is particularly important for vertically-integrated infrastructure providers that may be competing with third-party above rail operators for capacity or likely to compete with above rail operators for capacity in the future. Where this exists, there may be incentive for the business to discriminate in favour of its own operator.

The structure and operation of Queensland Rail is different from QR Limited and its related subsidiaries, which operated above rail freight services as well as below-rail infrastructure. Accordingly, while the queuing provisions of the AU2008 were arguably required to ensure transparency regarding capacity allocation by QR Network, this is no longer relevant as Queensland Rail is not competing directly with any above-rail operator and the allocation of capacity to Queensland Rail's passenger services is managed in accordance with the requirements under the *Transport Infrastructure Act 1994* (TIA).

The queuing mechanism also is not relevant to Queensland Rail given the nature of its customers, which less homogenous than the customers the QR Network. The absence of capacity on certain systems also significantly limits the conditions under which capacity is likely to become available.

In the absence of this anti-competitive risk and due to the limited relevance of a time-based queue to Queensland Rail, there are grounds for a simpler and less administratively costly approach which still achieves the principles of capacity allocation; that is, certainty regarding the process and criteria for capacity allocation, and equitable treatment of all access seekers.

The proposed arrangements for Queensland Rail's capacity allocation processes are also consistent with similar rail business in other Australian jurisdictions.

These matters are discussed in further detail below.

### 3.1 No anti-competitive risk

The Temporary Undertaking of Queensland Rail sets out detailed queuing provisions that allow Queensland Rail, under certain circumstances, to reorder the queue. The queuing arrangements in the Temporary Undertaking were first introduced by QR Limited in their 2006 Access Undertaking to provide access seekers with certainty regarding obtaining access rights, particularly in light of the potential conflict of interest where the business operated its own above rail operations and may have to decide whether to allocate capacity to its own above rail operator or a competing third-party operator.<sup>2</sup>

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<sup>2</sup> QCA. 2005. *Decision – QR's 2005 Draft Access Undertaking*. December 2005. Pg. 169.

Queensland Rail, however, is a vertically-integrated passenger business. The business does not directly compete with third-parties operating above rail freight train services and is not realistically able to do so during the proposed term of AU1. Queensland Rail can only undertake activities within the scope of its objects defined by the business' constitution.<sup>3</sup>

There also are no competing above-rail passenger services currently operating in Queensland in either the metropolitan or long-distance systems and there is no significant likelihood of a competing third-party passenger services emerging in the future. This is due to the loss-making character of passenger services and their reliance on significant government support (e.g. via transport service contract payments). Accordingly the emergence of a third-party passenger operator would be contingent on the operator securing government support and, particularly in respect to the metropolitan network, this would require a significant policy change by the Queensland Government.

Further, Queensland Rail operates above rail passenger services in accordance with the transport service contract arrangements negotiated between the Queensland Government and Queensland Rail. The train paths and timetables for passenger services are either given priority as a passenger service requirement as determined by the Director General of the Department of Transport and Main Roads (DTMR) under the *Transport Infrastructure Act 1994* (TIA) or use preserved train paths as defined by the TIA. Queensland Rail, therefore, does not allocate spare rail network capacity to its passenger services in competition with third party operators.

In particular, Section 266 of the TIA allows for the "Chief Executive" (the Director General of DTMR) to identify "passenger service requirements" in relation to regularly scheduled passenger services. Once those passenger service requirements are notified to Queensland Rail, Queensland Rail is required to give priority to the allocation of available train paths to satisfy those passenger service requirements (Section 266 (4)). In certain circumstances, Queensland Rail may be required by the Chief Executive, where a train path used by regularly scheduled passenger services is or becomes available, to allocate that train path to a stated passenger service (Sections 266 (5C)). This process of identifying and reserving capacity for passenger services occurs outside the formal access undertaking process and decision making responsibility resides with DTMR, rather than Queensland Rail.

In addition, section 266A of the TIA identifies "preserved train paths" relating to regularly scheduled passenger services and prevents these train paths from being allocated to non-passenger services, unless agreed to by the Chief Executive (Sections 266A (2) and (3)).

In the instance that a competing above rail third-party passenger operator entered the market, and such a scenario was contingent on the receipt of transport services contract payments, it would be expected that arrangements for the allocation of capacity would also be determined in accordance with the provisions of the TIA.

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<sup>3</sup> Under Rule 2.1 of Queensland Rail's Constitution, Queensland Rail is limited to only undertaking activities that are within the scope of its objects.

The allocation of rail capacity to Queensland Rail's passenger services, therefore, reflects the Government's public transport objectives, rather than any commercial decision of Queensland Rail. The effect of these arrangements with respect to capacity for passenger services is that while Queensland Rail technically is a vertically integrated business with both above rail and below rail activities, the business is effectively acting as a non-vertically integrated access provider in respect to third party access to its rail network.

## 3.2 Limited relevance to Queensland Rail's operations

The relevance of any queuing framework is also linked to capacity availability. The nature of appropriate queuing arrangements may differ based on whether there is available capacity, but competing request for access, or where there is no capacity available, and additional capacity is subject to the expansion of the rail network.

These matters are discussed further below.

### 3.2.1 *Competing requests for access*

There is no basis for applying a queuing framework to the systems on Queensland Rail's network where capacity exists as access is available to those users willing and able to negotiate access in accordance with the existing commercial terms.

In the event that more than one access seeker contemporaneously seeks access to capacity which is insufficient to meet both (or more) parties' requirement, a time-based queue does not provide the most efficient mechanism for managing this situation. This is due mainly to the diverse mix of general freight customers and coal customers serviced by Queensland Rail, compared to QR Network (which predominately serviced coal customers, with very similar commercial characteristics in terms of cost and risk). For Queensland Rail's customers, there is a much greater likelihood of differences in commercial outcomes, associated with cost and risk, particularly for non-reference train services.

Under the capacity allocation arrangement of the Temporary Undertaking, the business would be required to constantly adjust the queue in accordance with circumstances specified in clause 7.4.1(e) of the Temporary Undertaking.

AU1 therefore takes a principles-based approach which allocates capacity to access seekers based on a number of factors including the access charges which are expected to arise and the cost and risk associated with providing access (clause 2.7.2(a)(iv)).

### 3.2.2 *No capacity availability*

For systems where there is no available capacity, the arrangements for creating more capacity can be costly and complex, and link to how the costs of expanding capacity are distributed across users.

Queuing frameworks are particularly relevant where there is a clear process around making additional capacity available through infrastructure expansions and this is linked directly to the establishment of reference tariffs/access charges.

Dalrymple Bay Coal Terminal (DBCT), for instance, has a formal queue mechanism in place, generally consistent with the principle of first-in-time, first-in-right, though subject to certain conditions.<sup>4</sup> Under the applicable access undertaking as the costs of access are the same for all users, including new/potential users, expansion costs are socialised across the total terminal customer base. A formal queue mechanism provides a transparent way to allocate capacity between different users with otherwise equal commercial terms (i.e. there is no way to meaningfully contrast the 'cost' or 'risk' of providing access to different access seekers).

In the case of Queensland Rail, the costs associated with rail capacity expansions are managed differently. For example, there is currently no available capacity on the West Moreton system, and any increase in rail capacity would require significant capital expenditure to fund mainline expansions. The reference tariff for the West Moreton system does not support significant expansions to the system, associated with the duplication of certain segments of the system.

Accordingly, where Queensland Rail is not willing to fund a capacity expansion of the system, this would only occur if an access seeker, or group of access seekers, proposed to fund the expansion. In this situation a queue is not relevant to how capacity is allocated and provides little additional certainty to the access seekers, as the allocation of capacity relates to the user(s) willingness to pay to expand capacity, rather than their position in the queue. That is, under the current arrangement if an access seekers was at the start of the queue, but was unwilling to fund the expansions and there was another access seeker further back in the queue who was willing to fund the expansion, capacity would be allocated to the user willing and able to fund the expansion rather than the user at the front of the queue. A queuing mechanism in this scenario is therefore irrelevant.

### 3.3 Remove the cost and complexity of managing queues

AU1 is guided by a principle of ensuring the benefits of the access undertaking, in terms of the certainty and guidance it provides to access seekers, do not exceed the cost to Queensland Rail of administering the access arrangements. It also is guided by the principle of reducing the complexity of, and unnecessary detail in the access undertaking, and seeks to provide greater flexibility for Queensland Rail and access seekers to negotiate access terms appropriate for the particular circumstances of each system and access seeker.

Under the queuing provisions of the Temporary Undertaking, the management of the queue encompasses a number steps:

- Establishment of the queue:
  - For applications lodged prior to 30 June 2006, the first queue position is given to the access application most favourable in terms of the commercial performance of below rail services.

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<sup>4</sup> For example, in the 2010 Draft Access Undertaking for DBCT, the queuing arrangements included the condition that where access seekers agree to provide feasibility funding for expansions, they will take priority in the queue at that point in time (however the overall sequence of the queue does not change). (Queensland Competition Authority, 2010. *Final Decision – Dalrymple Bay Coal Terminal: 2010 Draft Access Undertaking*. September 2010. Pg. 22.)

- For applications lodged on or after 30 June 2006, the queue order is initially based on the lodgement date of the application.
- Maintenance of the queue – Once the queue is established, there are a range of circumstances which if satisfied permit the business to re-order the queue. This could, for example, occur where the business considers the commercial performance of below rail services is better served by allocating access to an access seeker who is in the queue but not currently first in the queue, or where a new access application is added to the queue.
- Where the commercial performance of below rail services is relevant to the re-ordering of the queue, assessing the ability of an access seeker to contribute to the commercial performance of below rail services – This process involves comparing the net present value (NPV) contribution to the common costs of providing rail infrastructure for the total haul for the different traffics subject to the different access applications in the queue. In certain instances, where differences in the NPV contribution to common costs between different traffics exceed a threshold amount, the business may alter the ordering of the queue.
- Notification process – where the business changes the order of the queue it is necessary for the business to notify each access seeker in the queue of any change to the position of their access application in the queue and advise on the reasons for the change.

For QR Limited, these queuing arrangements were more suitable as the majority of access seekers reflected one major freight type (i.e. coal), particularly for the central Queensland coal network, and there were minimal differences in commercial characteristic of access arrangements, thereby removing the requirement to constantly reorder of the queue.

Queensland Rail, however, services a diverse mix of general freight customers and coal customers. Continuing to be subject to the queuing arrangements under the Temporary Undertaking would result in the business continuously reviewing and, potentially, adjusting the queue; creating unnecessary administrative activities and costs for the business, which do not provide any real benefits for access seekers.

AU1 therefore takes a principles-based approach, which will remove the requirement and associated costs of managing a queue. These costs are no longer warranted in the absence of anti-competitive risk and due to limited relevance of the queue given the current circumstances of Queensland Rail with respect to capacity availability.

### 3.4 Consistency with capacity allocation arrangements in other jurisdictions

Queensland Rail's proposed capacity management framework are consistent with the capacity allocation frameworks in place by other below rail providers in Australia, which allow capacity to be allocated to the freight access seeker which in the business' opinion, is most favourable, or will best utilise the available capacity.

For example, Metro Train Melbourne (MTM)<sup>5</sup> does not have a formal queuing mechanism in place and access requests for competing freight services are determined on the basis of whether the access seeker provides the greatest utilisation of the network. V/Line<sup>6</sup> also allocates capacity on the basis of which access seeker provide the greatest utilisation of the network.

There are also no queuing provisions in Australian Rail Track Corporation's (ARTC's) 2008 Interstate Access Undertaking. ARTC has the ability to allocate capacity to the Access Seeker that, in ARTC's opinion, is most favourable to ARTC and subject to commercial criteria.

Further details regarding the capacity allocation provisions for MTM, V/Line and ARTC is provided in Appendix A.

### 3.5 Conclusion

The capacity allocation provisions proposed by Queensland Rail for AU1 are appropriate for the purposes of their new access arrangements, on the basis that proposed the arrangements continue to provide certainty for the access seeker regarding the factors which will be considered in allocating capacity between competing access seekers, while removing the administrative costs to Queensland Rail associated with managing a queue, which has little relevance, or benefits in terms of competition, under the new business structure.

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<sup>5</sup> Metro Train Melbourne is an access provider for the Victorian metropolitan rail network. It also provides suburban/metropolitan above rail passenger services.

<sup>6</sup> V/line is a provider of rail access for the Victorian regional rail network. It also operates above rail passenger services across regional Victoria.

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## Appendix A Capacity management provisions of other below rail infrastructure providers

### *Metro Trains Melbourne*

Metro Trains Melbourne (MTM) is an access provider for the Victorian metropolitan rail network. The business is regulated by the Essential Services Commission (ESC) and is currently operating under an access arrangement approved by the ESC which commenced 24 August 2011 and will expire on 1 July 2016.

The Capacity Allocation Protocol (Attachment F of the MTM Access Arrangement<sup>7</sup>) outlines MTM's approach to the allocation of available Train Paths. There are no queuing provisions in the protocol. Competing access requests are assessed on the basis of providing access to an operator a passenger service in priority to a freight service and, for competing freight services, to the access seeker that provides the greatest utilisation of the network. Specifically, Section 5 (Assessment of a request to provide a declared rail transport service) states:

- 5.3 *Where there is more than one application for an Unscheduled Train Path the Access Provider must make a determination as follows:*
- a) *Determine whether an alternative Unscheduled Train Path would satisfy the access requirements of any of the applications, consistent with the concept of passenger priority; then*
  - b) *Secondly, should an alternative Unscheduled Train Path not be available, allocate the Unscheduled Train Path to a Third Party Operator wishing to run Passenger Trains; then*
  - c) *Thirdly, allocate the Unscheduled Train Path to the future Third Party Operator or Operator wishing to run freight Trains with the greatest utilisation of the Network.*
- 5.4 *In determining "greatest utilisation" the Access Provider will consider relevant factors including:*
- a) *The duration of use of the Train Path;*
  - b) *The frequency of use of the Train Path;*
  - c) *The aggregate tonnage of the freight services; and*
  - d) *In the event that there is more than one application for the same Unscheduled Train Path where each application is associated with servicing the same freight task, any contractual commitment that the Operator seeking access can demonstrate.*

These provisions seek to ensure that no Train Path will be allocated to a freight operator that conflicts with the concept of passenger priority. It also allows the access provider the ability to allocate capacity to the freight operator that will

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<sup>7</sup> Metro Trains Melbourne, 2011. *Access Arrangement – 24 August 2011.*

provide the greatest utilisation of the Train Path. Section 6 of the MTM Access Arrangement provides a description of the required degree of utilisation and further requirements of the access provider in this process.

## *V/Line*

V/Line Passenger Pty Ltd (V/Line) is a provider of rail access services in regional Victoria. V/Line's access arrangements are regulated by the ESC. V/Line's current access arrangement was approved by the ESC in June 2009 and expires on the third anniversary of the commencement date.

Under clause 5.3(c) of the V/Line Access Arrangement<sup>8</sup>, if two Operators require the same Available Path, priority will be determined in accordance with the Operating Handbook.

The Operating Handbook<sup>9</sup> sets out the Network Services Department (NSD) capacity allocation principles and network management protocols for Access Seekers/Train Operators to access the NSD network. There are no queuing provisions for Access Seekers. Part 3 (NSD capacity allocation and network management) provides that capacity allocation is carried out in a manner that is consistent with the principle of passenger priority and in a way that will encourage maximum use of the network. Specifically:

*If the NSD assessment determines that there is insufficient Available Capacity to satisfy the Access application NSD shall:*

- a) attempt to find an alternative Train Path that satisfies the requirements of the Access Seeker; and*
- b) make an assessment of whether part of the Access Seeker's request can be satisfied with Available Capacity; and*
- c) provide a written explanation to the Access Seeker within 24 hours of the receipt of the Access application as to why the Access Seeker's request could not be satisfied in full showing the Available Capacity of the Line and the existing Scheduled Train Paths on the Line which conflict with the Access application.*

*If two or more Access Seekers request the same available Freight Train Path and if it is not possible to satisfy all requests by using alternative similar Train Paths, NSD will be obliged to allocate the available Train Path to the Access Seeker from which the greatest Utilisation of the Network is achieved by operating the freight service. NSD's judgment of greatest Utilisation will consider the following aspects that are listed in order of importance:*

- a) frequency of Train Path usage;*
- b) aggregate tonnage comparison;*
- c) duration of Train Path usage.*

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<sup>8</sup> V/Line Passenger Pty Ltd, 2009. *Access Arrangement*, 17 June 2009.

<sup>9</sup> V/Line, 2009. *Network Services Department- Track Access Operating Handbook*, Revision 08, 5 August 2009.

*NSD will not require Access Seekers to identify consignees as part of the assessment process. NSD will provide written advice to the Access Seekers outlining the judgment made based on the assessment of the Utilisation benefits.*

This approach is similar to the approach of MTM, in that the access provider is required to allocate capacity first to a passenger operator and, then for competing freight operators, to the freight operator (Access Seeker) that will provide the greatest utilisation of the Train Path.

### *Australian Rail Track Corporation Limited*

The Australian Rail Track Corporation Limited (ARTC) was established as the entity to manage the granting of access to rail operators to the Interstate Rail Network. It is regulated by the Australian Competition and Consumer Commission (ACCC). The current access undertaking for the interstate network was approved by the ACCC in July 2008 and applies for a 10 year term.

Clause 5.2 provides for the allocation of capacity where competing access applications for access exist.<sup>10</sup> The clause states:

- (a) *In the event of multiple Applicants and subject to clause 5.2(b), Access Rights will be allocated to the Applicant with whom ARTC can negotiate and execute an Access Agreement which, in the opinion of ARTC, is most favourable to it.*
- (b) *As previously stated in this Undertaking (Clause 3.10(b)(d)), if, at any time, two or more Applicants are seeking access with respect to mutually exclusive Access Rights, each of the Applicants who have received an Indicative Access Proposal with respect to those mutually exclusive Access Rights will be so advised. In such circumstances, ARTC is entitled to seek to finalise an Access Agreement in respect of such Access with the Applicant with whom ARTC can agree terms and conditions, including Charges, which are considered in the opinion of ARTC, to be most favourable to it. Ordinarily, but without limiting ARTC's discretion in this regard, ARTC would make such a decision based on the Access Agreement that represented the highest present value of future returns to ARTC after considering all risks associated with the Access Agreement.*

ARTC does not have a queuing arrangement for capacity allocation in its Interstate Access Undertaking. ARTC has the ability to allocate capacity to the Access Seeker that, in ARTC's opinion, is most favourable to ARTC – presumably on commercial criteria.

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<sup>10</sup> ARTC, 2008. *ARTC Interstate Access Undertaking*, 15 July 2008.

In the ACCC Final Decision of ARTC's Access Undertaking (Interstate Rail Network) in 2008 the ACCC reviewed the capacity allocation arrangements in other jurisdictions. In this assessment the ACCC observed that the QCA considered the capacity reservation fee to be inappropriate, and required QR Limited (QR Network) to incorporate a queuing system for rail access that provided an alternative mechanism by which capacity would be reserved. Such a system was considered to be most relevant when two or more access seekers were seeking mutually exclusive access rights and that such a mechanism would provide access seekers with some surety over access rights under negotiation as well as assist with an access seeker's forward planning.

While the ACCC acknowledged the merits of the queuing system adopted by QR Network, it argued that the efficacy of a queuing system in the case of ARTC was questionable given that the underlying intention of the queuing system was to limit the market power of QR Network (given that QR Network could use the negotiating process as a means by which access applications could be stalled in favour of QR Network's own above-rail operations). As ARTC is not vertically integrated, the ACCC considered there are fewer concerns to warrant the adoption of a queuing system.<sup>11</sup>

### *Brookfield Rail (WestNet Rail)*

Brookfield Rail (formerly WestNet Rail (WNR)) is a provider of below rail freight infrastructure, covering approximately 5,000 kilometres of track in Western Australia. The Train Path Policy<sup>12</sup> (TPP) sets out the policy for allocation of Train Paths and the provision of access to Train Paths. Section 5 discusses the approach to competition for the same train path and embodies a first-in-time, first-in-right principle for competing requests. Specifically,

*If two Operators request the same available Train Path and it is not possible to satisfy both requests by using alternative but similar Train Paths, the available Train Path will be provided to the Operator who first requested the Train Path and can establish that it has a requirement for the Train Path. Whether a requirement exists will be determined on the basis of the criteria set out in 2.2.1 of the T.P.P.*

Clause 2.2.1 specifies the guidelines for assessing whether a request is warranted for a train path.

### *The Pilbara Infrastructure Pty Ltd*

The Pilbara Infrastructure Pty Ltd (TPI), a wholly-owned subsidiary of Fortescue Metals Group (FMG), owns and operates a rail network and port terminal in the Pilbara region in Western Australia.

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<sup>11</sup> ARTC. 2008. *Final Decision – Australian Rail Track Corporation: Access Undertaking – Interstate Rail*. July 2008. Pg. 186

<sup>12</sup> WNR, 2009, *Train Path Policy*, April 2009.

The Train Path Policy<sup>13</sup> (TPP) sets out TPI's policy for the allocation of Train Paths. The clauses relating to capacity allocation are similar to Brookfield Rail in that if two operators request the same available Train Path and it is not possible to satisfy both requests by using alternative but similar Train Paths, the available Train Path will be provided to the Operator who first requested the Train Path and can establish that it has a requirement for the Train Path (Section 2.3).

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<sup>13</sup> The Pilbara Infrastructure Pty Ltd, 2010, *The Train Path Policy*, 22 February 2010.

# Attachment 4: PWC Supporting Analysis – Pricing Principles

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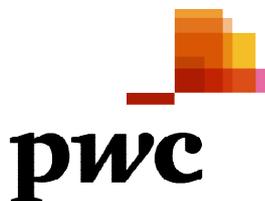
# *Queensland Rail*

## Pricing principles

*Queensland Rail*

*Supporting analysis for  
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# 1 Introduction

## 1.1 Background

Queensland Rail commenced business independently from the QR National corporate group on 1 July 2010. Queensland Rail's primary business is the delivery of public transport through the provision of passenger rail services and supporting private freight services through the provision of rail infrastructure.

Since 1 July 2010, Queensland Rail has provided access to its below rail network under QR Network's 2008 Access Undertaking (as at 30 June 2010) to the extent that it was made to apply to Queensland Rail by a transfer notice and project direction (Transfer Notice) dated 29 June 2010 under the *Infrastructure Investment (Asset Restructuring and Disposal) Act 2009* (Qld) (Temporary Undertaking).

In light of the new structure of the business and the approaching expiry of the Temporary Undertaking, Queensland Rail is preparing a draft access undertaking (Queensland Rail Access Undertaking 1 (AU1)) to submit to the Queensland Competition Authority (QCA). AU1 seeks to provide an access undertaking that better suits the operations and requirements of Queensland Rail, whilst preserving the basic process for access seekers to negotiate access terms, and simplifying the Temporary Undertaking to be better understood by all parties.

## 1.2 Purpose and approach

Part 3 of the proposed AU1 describes the pricing principles that Queensland Rail will apply in the negotiation of access charges with access seekers and includes provisions regarding pricing objectives, revenue adequacy, limits on price differentiation, reference tariffs and rate review provisions.

The purpose of this paper is to describe the differences between the pricing principles proposed for AU1 and the Temporary Undertaking and to discuss the appropriateness of these differences. This paper considers the current operations of the business as well as the consistency of the pricing principles with economic first principles. This paper also reviews the pricing principles applied by other below rail access providers where relevant.

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## 2 Pricing principles for AU1

Queensland Rail is seeking to develop an access undertaking that reflects the current requirements of the business. The current business' primary activities relate to the delivery of public transport services through the provision of passenger rail services, and below rail infrastructure services for coal and freight train operators, which it does in accordance with the transport services contracts in place with the Queensland Government. The business does not operate, and has no intention of operating its own above rail freight trains, as this is inconsistent with the business' constitution and its customer charter.

The guiding principle for AU1 is to develop an access undertaking that provides greater flexibility for Queensland Rail and access seekers to negotiate access terms appropriate for the particular circumstances of each system and access seeker. While Queensland Rail has been operating in accordance with the Temporary Undertaking, that document is essentially QR Network's 2008 Access Undertaking (2008AU) which was developed for a completely different business, with different operational and competitive characteristics. While Queensland Rail's AU1 has been developed taking into consideration the overarching regulatory principles of the access undertakings of QR Network, the proposed AU1 should be viewed as a new document for a new business.

Accordingly, a number of differences are apparent between the Temporary Undertaking and the proposed AU1, including for Part 3 of AU1, which details the provisions regarding the pricing principles that Queensland Rail will apply in the negotiation of access charges with access seekers.

The proposed pricing principles provisions are largely consistent with the pricing principles in the Temporary Undertaking, which in turn are based on generally accepted regulatory principles. There is however some differences due to general formatting and structural changes which seek to clarify existing arrangements and remove unnecessary detail from the access undertaking whilst retaining the overall intent of the provisions.

Some differences in the AU1 pricing principles from the Temporary Undertaking seek to ensure that the pricing principles do not impose unnecessary and costly regulatory compliance on the business, while providing little additional benefit or certainty for access seekers. The inclusion of more prescriptive and detailed provisions in the Temporary Undertaking was to mitigate any potential anti-competitive risk in relation to QR Limited, which operated above rail coal and freight services. Queensland Rail is a very different business and as its primary business activity is not operating in a competitive market, hence the potential for the business to use its market power to advantage its own operations has been removed.

The following sections provide a detailed discussion of these differences.

### 3 Pricing principles

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><b>Revenue Adequacy</b></p> <p>The Temporary Undertaking allows Queensland Rail to earn revenue from access provision sufficient to achieve full recovery of efficient costs, including an adequate rate of return on assets (Subclause 6.3.2), provided Queensland Rail complies with the pricing constraints in:</p> <p>Subclause 6.1.1 – Limits on Price Differentiation; Subclause 6.1.2 – Establishment of access charges for QR Train Services; and Clause 6.2 – Pricing Limits.</p> <p>Further, where the business earns revenue in excess of this, the first objective of the business will be to reduce the Transport Service Payments (TSPs)<sup>1</sup>.</p>	<p>Under Clause 3.1.1 of the proposed AU1:</p> <p><i>Queensland Rail is entitled to earn revenue from providing Access, including from Access Charges and Transport Service Payments, that is at least enough to:</i></p> <p>(a) <i>fully recover all Efficient Costs; and</i> (b) <i>provide a return on the value of assets and investment commensurate with the regulatory and commercial risks involved.</i></p> <p><i>If Queensland Rail earns revenue in excess of this, then Queensland Rail may seek to reduce Transport Service Payment rather than Access Charges.</i></p>	<p>The proposed provisions regarding revenue adequacy are largely unchanged from the Temporary Undertaking. The reference to pricing limits and limits on price differentiation are not included as specific provisions regarding these matters have been included elsewhere in Part 3 of AU1 (including Clause 3.2, addressing pricing limits and the application of ceiling and floor revenue limit, and Clause 3.3, regarding limits on price differentiation).</p> <p>Moreover, unlike the vertically-integrated QR Limited, Queensland Rail does not operate competing above rail services such that there is no incentive for the business to use price differentiation, higher access charges, and access conditions to prevent or hinder access to third party access seekers.</p> <p>The proposed drafting of the clause also maintains the provisions which allow the business to reduce TSPs where revenue is greater than specified in this provision. This is consistent with earlier QCA decisions that TSPs rather than access charges should be reduced to ensure that QR Limited does not exceed its allowable revenue.<sup>2</sup></p>

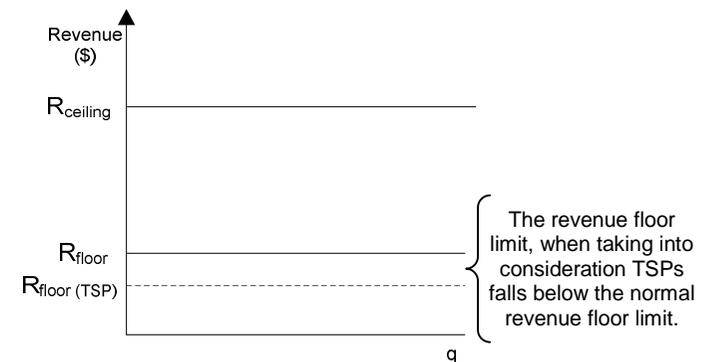
<sup>1</sup> Transport Service Payments are payments to Queensland Rail from the Department of Transport and Main Roads for specified below rail services for nominated sections of the network.

<sup>2</sup> QCA. 2005. Decision: *QR's 2005 Draft Access Undertaking*. December 2005.

Temporary Undertaking	Proposed amendment to AU1	Discussion
<b>Pricing Limits</b>		
<i>Ceiling revenue limit</i>		
<p>Subclause 6.2.2 and 6.2.3 of the Temporary Undertaking requires that access charges be set such that they do not, over an evaluation period, exceed the expected stand alone cost of providing access (after giving consideration to the level of contribution provided by TSPs towards the relevant rail infrastructure) to an individual train service or combination of train services (as applicable).</p> <p>Further, where it is necessary to determine whether access charges are consistent with this limit, a revenue limit will be established for the individual train service or combination of train services (as applicable).</p> <p>The revenue limit is defined in Subclause 6.2.4 as:</p> <p>(a) <i>the Revenue Limit will be determined as the maximum amount of expected revenue, including:</i></p> <p>(i) <i>Access Revenue (determined consistent with Paragraph 6.2.3(c)) that may be earned from Access Charges; and</i></p> <p>(ii) <i>where the Individual Train Service or combination of Train Services (as appropriate) includes all of the Train Services using a section of the Rail Infrastructure, any Transport Services Payments towards the relevant section of Rail Infrastructure,</i></p> <p><i>over the Evaluation Period, measured such that the net present value of the cashflows associated with providing Access for the Individual Train Service or combination of Train Services (as appropriate) over the Evaluation Period is zero.</i></p> <p>The formula which describes this calculation is provided in Appendix A.</p>	<p>Clause 3.2.1 requires that Queensland Rail set the methodology, rates and other inputs for calculating access charges such that the expected revenue from an individual train service or combination of train services (as applicable) does not, over an evaluation period, exceed the relevant ceiling revenue limit.</p> <p>The ceiling revenue limit is the aggregate of the following (Clause 3.2.3):</p> <p>(i) <i>the maximum amount of Expected Access Revenue; and</i></p> <p>(ii) <i>where the Access Seeker's proposed Train Services comprise all of the Train Services using the relevant part of the Network, the Transport Services Payments (if any) that are reasonably expected to be received by Queensland Rail in respect of that part of the Network (on a pro rata basis for that individual Train Service or combination of Train Services, as applicable),</i></p> <p><i>over the Evaluation Period where the Ceiling Revenue Limit is measured such that the net present value of the cashflows associated with providing Access for the relevant Train Service(s) over the Evaluation Period is zero.</i></p> <p>The formula which describes this calculation is provided in Appendix A.</p>	<p>The provisions regarding the ceiling revenue limit, including the relevant formula for the calculation of the ceiling revenue limit, are consistent with the Temporary Undertaking. There are however, minor changes to the wording to clarify the intent of the provisions, and to reduce unnecessary repetition.</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><b>Floor Revenue Limit</b></p> <p>Subclause 6.2.2 and 6.2.3 of the Temporary Undertaking requires that access charges be calculated such that they do not, over an evaluation period, fall below the expected incremental costs of providing access to an individual train service or combination of train services (as applicable).</p> <p>In determining the expected incremental costs of providing access to a combination of train services consideration must be given to the level of contribution provided by TSPs towards the relevant rail infrastructure.</p>	<p>Clause 3.2.2 gives Queensland Rail a discretion to set the methodology, rates and other inputs for access charges such that the expected revenue from an individual train service or combination of train services (as applicable) does not, over an evaluation period, fall below the floor revenue limit (Clause 3.2.2(a)).</p> <p>However, Queensland Rail must, under Clause 3.2.2(b), only exercise this discretion where:</p> <ul style="list-style-type: none"> <li>• TSPs are applied to that part of the network used by the relevant train services;</li> <li>• once TSPs are taken into account, the Expected Access Revenue would not fall below the Floor Revenue Limit; and</li> <li>• the methodology, rates and inputs for calculating the relevant access charges includes a mechanism that allows Queensland Rail to vary the access charges from time to time in response to any decrease in the relevant TSPs.</li> </ul> <p>The floor revenue limit is defined as:</p> <p><i>...the level of revenue that will recover the expected Incremental Cost of providing Access to the individual Train Service or combination of Train Services, as applicable.</i></p> <p>Incremental costs are defined as the costs of providing Access that:</p> <p>(a) <i>would not be incurred by Queensland Rail if the individual Train Service or combination of Train Services (as applicable) did not operate on the basis of the assets reasonably required for the provision of Access, including:</i></p> <ul style="list-style-type: none"> <li>(i) <i>capital (renewal and expansion) costs; and</i></li> <li>(ii) <i>the cost of bringing expenditure forward in time; and</i></li> </ul> <p>(b) <i>are assessed as Efficient Costs.</i></p>	<p>The proposed differences seek to clearly state the business' ability to set the methodology, rates and other inputs for access charges such that the expected revenue from an individual train service or combination of train services (as applicable) may fall below the floor revenue where TSPs exist.</p> <p>As illustrated in Figure 1, it may be possible for the business to set access charges at a level such that the expected access revenue from those train services or combination of train services fall below the floor revenue limit (<math>R_{\text{floor}}</math>)/incremental cost. This situation however, is limited to instances where TSPs are received for that part of the network, and accordingly these payments will cover any revenue shortfall (i.e. while charges are set below the floor revenue, the business will still recover the expected incremental cost of providing access).</p>

**Figure 1 – Pricing below the Floor revenue limit**



Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Cross subsidy</i></p> <p>In the Temporary Undertaking, Subclause 6.2.1 requires Queensland Rail to, in determining access charges for both individual train services and combinations of train services (as applicable), observe upper and lower limits for access charges established at levels which ensure there is no cross-subsidy between individual train services or combinations of train services (as applicable).</p> <p>In particular, Subclause 6.2.1 states:</p> <p><i>In determining Access Charges, [Queensland Rail] will observe price limits in respect of the following elements:</i></p> <ul style="list-style-type: none"> <li><i>(i) upper and lower limits for Access Charges for individual Train Services, established at levels which ensure there is no Cross Subsidy between Individual Train Services and determined in accordance with Subclause 6.2.2; and</i></li> <li><i>(ii) upper and lower limits for Access Charges in respect of combinations of Train Services, established at levels which ensure that there is no Cross Subsidy between combinations of Train Services and determined in accordance with Subclause 6.2.3.</i></li> </ul> <p>(Where subclause 6.2.2 and 6.2.3 define the price limits for individual train services and train service combinations respectively.)</p>	<p>The proposed drafting of AU1 does not include specific provisions which expressly seek to ensure there is no cross-subsidisation between individual train services or a combination of train services.</p> <p>However, it is important to note that under AU1 access charges are set subject to a ceiling revenue limit and floor revenue limit, as discussed above.</p>	<p>Cross-subsidisation is defined as a situation where at least one service pays above stand alone costs and another service pays below incremental cost.<sup>3</sup> Cross-subsidisation requires both conditions to be met. Hence, while Queensland Rail can, in certain circumstances, set access charges such that the expected revenue from access charges may fall below the floor revenue limit (taking into consideration TSPs), cross-subsidisation will only exist where this shortfall is met by another service paying more than stand-alone cost – a condition which is precluded by Clause 3.2.1 of AU1, and commercially unrealistic given the nature of the traffic using Queensland Rail's network.</p> <p>In the ACCC's assessment of the 2008 ARTC Interstate Access Undertaking, it considered the potential for cross-subsidisation where the business can set access charges below incremental costs. Its assessment found that charging below incremental cost is not an issue unless at least one access seeker or group of access seekers pays above their stand alone costs; a situation which is prohibited under ARTC's Access Undertaking. The ACCC also considered that cross-subsidisation was unlikely to be an issue because the forecast revenue of all ARTC's segments during the term of the undertaking was expected to be well below the respective revenue ceiling for all segments.<sup>4</sup></p> <p>The objective of the pricing limit clauses included in the 2008AU (which are present in the Temporary Undertaking) were to ensure that QR Network was not able to use price differentiation to advantage other QR business groups or to disadvantage/hinder access to competing above rail operators. However, as Queensland Rail does not operate above rail freight services and is not in direct competition with any above rail operator, there is no scope for the business to use price differentiation to benefit its own operators in a related market.</p> <p>There is no necessity for an equivalent to Subclause 6.2.1 of the Temporary Undertaking in AU1. Clauses 3.2.1 and 3.2.2 of AU1 stipulate the requirements for setting access charges in accordance with a ceiling revenue limit and a floor revenue limit and this mitigates</p>

<sup>3</sup> Faulhaber, G.R. 1975 'Cross-Subsidization: Pricing in Public Enterprises,' *The American Economic Review*, 65(5), pp. 966-977.

<sup>4</sup> ACCC. 2008. *Final Decision Australian Rail Track Corporation: Access Undertaking – Interstate Rail Network*. July 2008.

Temporary Undertaking	Proposed amendment to AU1	Discussion
		<p>the potential for cross-subsidisation.</p> <p>In addition, in relation to regularly scheduled passenger services, Queensland Rail must also comply with its obligations under section 266(6) of the <i>Transport Infrastructure Act 1994</i> (Qld) which states that:</p> <p><i>In charging for access to regularly scheduled passenger services (an access charge), a railway manager must not—</i></p> <ul style="list-style-type: none"> <li><i>(a) differentiate between similar regularly scheduled passenger services operating or proposed to operate over the same route at different times of the day; or</i></li> <li><i>(b) set an access charge for a train path that is greater than the access charge set for similar train paths.</i></li> </ul>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Limits on price differentiation</i></p> <p>Under the Temporary Undertaking, where a reference tariff is applicable for a train service type, the access charge may only vary from the reference tariff to reflect differences in the cost and risk to Queensland Rail of providing access for the train service compared to the reference train service.</p> <p>Where there is no reference tariff applicable for a train service type, the access charge may only vary from the access charge for other train services transporting the same commodity in the same geographic area, on a unit rate basis:</p> <ul style="list-style-type: none"> <li>• to reflect differences in the cost and risk to Queensland Rail of providing access for the train service compared to other train services of that type; or</li> <li>• over time, to reflect: <ul style="list-style-type: none"> <li>○ changes in the cost or risk to Queensland Rail of providing access;</li> <li>○ changes in relevant TSPs (where the change has the result that Queensland Rail can no longer commercially provide access in that specified geographic area at the current access charges);</li> <li>○ “Changes in Market Circumstances”; or</li> <li>○ limitations on available capacity.</li> </ul> </li> </ul> <p>Further, subclause 6.1.2 prohibits the business from setting access charges for Queensland Rail train services for the purpose of preventing or hindering access by third party access seekers into any market in competition with Queensland Rail.</p>	<p>Under AU1, Queensland Rail may vary the methodology, rates and other inputs for calculating access charges from an applicable reference tariff to reflect differences in the cost and risk to Queensland Rail of providing access to an access seeker compared to the basis on which the reference tariff was determined (Clause 3.3(b)(i)).</p> <p>If there is no applicable reference tariff for a train service, Queensland Rail may vary the methodology, rates and other inputs for calculating access charges for an access seeker's train service from another train service with similar characteristics:</p> <ul style="list-style-type: none"> <li>• on a unit rate basis to reflect differences in the cost and risk to Queensland Rail of providing access compared to other access seekers or access holders (Clause 3.3(b)(ii)(A))<sup>5</sup>, and</li> <li>• to reflect: <ul style="list-style-type: none"> <li>○ changes that result in Queensland Rail no longer being able to commercially provide access to train services in that geographical area at the current access charges (Clause 3.3(b)(ii)(B)(1));</li> <li>○ changes in the cost and risk to Queensland Rail of providing access (Clause 3.3(b)(ii)(A)(2));</li> <li>○ changes in circumstances which have had, or may have, a material effect on ability or willingness of access holders/seekers to pay access charges (Clause 3.3(b)(ii)(B)(3)); or</li> <li>○ limitations on available capacity (Clause 3.3(b)(ii)(B)(4)),</li> </ul> </li> </ul> <p>over time.</p>	<p>Price differentiation is supported under the <i>Queensland Competition Authority Act 1997</i> where it aids efficiency (Section 168A(b)).</p> <p>The proposed clauses regarding Limits on Price Differentiation in AU1 allow for price differentiation in accordance with the circumstances specified in Clause 3.3. These clauses are similar to the limits imposed in the Temporary Undertaking; though clarify the circumstances in which Queensland Rail may differentiate prices between access seekers/holders to include changes that might impact on the business' ability to commercially provide access to train services in a particular geographical area at the current charges. Such changes may include variations to relevant TSPs (which is also included in Subparagraph 6.1.1(c)(ii)(B) of the Temporary Undertaking), or broader factors such as changes in operating and maintenance costs and changes to the utilisation of the network (e.g. a reduction in users may impact on how charges are set for remaining users).</p> <p>The proposed drafting also removes the prohibition on Queensland Rail from establishing access charges for QR Train Services for the purposes of preventing or hindering access by a third-party access seeker. These provisions are no longer necessary following the restructure of the business.</p> <p>Provisions to impose limits on price differentiation were introduced in QR Limited's 2001 Access Undertaking to ensure the business did not differentiate access charges between access seekers and/or access holders for the purpose of adversely affecting competition within a relevant market. This potential for adversely affecting competition was deemed by the QCA as a likely risk for the vertically integrated QR Limited.</p> <p>The structure and nature of the current Queensland Rail business is very different from QR Limited. The business no longer operates above rail freight services and hence there is no scope for the business to use price differentiation to prevent or hinder access by competing third party access seekers to benefit its own operations.</p>

<sup>5</sup> For the calculation of access charges for non-reference tariff services, Queensland Rail will determine whether the characteristics of Train Services are similar having regard to all relevant matters including, but not limited to, geography, the origin and destination, duration and quality of the Train Path including arrival and departure times of the day and week, nature of rolling stock and train configuration, characteristics of the train services, the commodity transported or transport service and the duration and terms of the relevant access agreement.

<b>Temporary Undertaking</b>	<b>Proposed amendment to AU1</b>	<b>Discussion</b>
<p>Subclause 6.1.2 states:</p> <p><i>In developing Access Agreements with QR or a Related Party of QR in accordance with Subclause 5.3, [Queensland Rail] will not establish Access Charges for QR Train Services for the purpose of preventing or hindering Access by a Third Party Access Seeker into any market in competition with the QR Operational Business Group.</i></p>	<p>AU1 does not include an express requirement that Queensland Rail will not establish access charges for the purposes of preventing or hindering access by a third-party access seeker who is in competition with Queensland Rail.</p>	<p>The amendments to the limits on price differentiation provisions therefore achieves the balance of imposing appropriate restrictions on the business, while still allowing the business to differentiate access charges under set circumstance to ensure the efficient utilisation of its below rail network.</p> <p>In addition, in relation to regularly scheduled passenger services, Queensland Rail must also comply with its obligations under section 266(6) of the <i>Transport Infrastructure Act 1994</i> (Qld) which includes requirement regarding how access charges must be set. A full extract of this provision is provided in the above section (Cross Subsidy).</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Hierarchy of pricing principles</i></p> <p>Clause 6.1 of the Temporary Undertaking addresses circumstances where a conflict between pricing principles occurs. The clause states:</p> <p><i>In developing Access Charges [Queensland Rail] will apply the pricing principles set out in this Part 6. In the event of a conflict between these pricing principles, [Queensland Rail] will apply the pricing principles in the following order of precedence (from highest to lowest):</i></p> <ul style="list-style-type: none"> <li><i>(a) Limits on Price Differentiation (Subclause 6.1.2)</i></li> <li><i>(b) Pricing limits (Clause 6.2)</i></li> <li><i>(c) Rail Infrastructure Utilisation (Subclause 6.3.1)</i></li> <li><i>(d) Revenue Adequacy (Subclause 6.3.2).</i></li> </ul> <p>This hierarchy refers to the potential for a conflict between pricing principles. Under Clause 6.1, the business would not, for example, be able to fail to comply with the Limits on Price Differentiation in order to comply with Revenue Adequacy. Similarly, complying with Limits on Price Differentiation also take precedence over complying with floor or ceiling price limits, irrespective of whether the resulting access charges cover the incremental costs of the individual train services.</p>	<p>AU1 does not include a hierarchy of pricing principles.</p>	<p>The QCA determined during its consideration of the QR Limited's 2005 Draft Access Undertaking that the access undertaking should include a priority order for the application of pricing principles.<sup>6</sup> The provisions were also included in the 2008AU, and therefore are included in the Pricing Principles in the Temporary Undertaking.</p> <p>Queensland Rail has not included equivalent provisions in AU1 as the access undertaking contains provisions regarding the requirement to set charges in accordance with the ceiling revenue limit and the limits on price differentiation.</p> <p>Moreover, unlike the former vertically-integrated QR Limited, there is no scope for the business to use price differentiation or higher access charges to prevent or hinder access to competing third party access seekers. Accordingly, the guidance offered by a hierarchy provision is unnecessary and has therefore not been included in AU1.</p>

<sup>6</sup> QCA. 2005. *Draft Decision: QR's 2005 Draft Access Undertaking*. July 2005

Temporary Undertaking	Proposed amendment to AU1	Discussion
<b>Structure of access charges and conditions of access</b>		
<p><i>Structure of access charges</i></p> <p>Under subclause 6.5.1, where a reference tariff applies for a train service type, the structure of access charges for that train service type will be in accordance with the documentation for that reference tariff. If no reference tariff applies for the train service type, the structure of access charges for that train service type will be negotiated on a case-by-case basis and Paragraph 6.5.1(b) details the structure that these access charges may take. Access charges for any train service type may also include a QCA levy component to be collected by Queensland Rail for the QCA.</p>	<p>The proposed AU1 does not include provisions detailing arrangements for the structure of access charges. However, clause 3.6 states, consistent with Paragraph 6.5.1(c) of the Temporary Undertaking, that an access charge may include a QCA levy component collected for the QCA by Queensland Rail.</p>	<p>The provisions regarding the structure of access charges are not included in AU1 on the basis that these provisions provided little additional certainty for users regarding the structure of access charges (the provisions only indicated, in the case of access charges where no reference tariff applies, the structure that access charges <i>may</i> take).</p> <p>Details regarding the arrangements for access charges are provided for in Clause 4.1 of the Standard Access Agreement and Section 4 of the Access Agreement Principles. For example, Section 4 of the Access Agreement Principles indicates that the access agreement must set out the access charges agreed between the parties. These arrangements allow for Queensland Rail and the access seeker to negotiate access charges and the access charges structure in accordance with the specific requirements of the train services being operated and the system on which it is operating.</p> <p>Accordingly, AU1 does not include provisions for the structure of access charges and this is consistent with the overarching objective to reduce the complexity of the access undertaking and to remove unnecessary detail.</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Conditions of access</i></p> <p>Paragraph 6.5.2(a) gives Queensland Rail the ability to require an access seeker to agree to conditions (in addition to those in the relevant Standard Access Agreement) before being granted access rights – that is, access conditions – to the extent that this is reasonably required to mitigate the business’ exposure to financial risks associated with providing access for the access seekers proposed train services.</p> <p>Paragraphs 6.5.2(b) and (c) refer to specified circumstances where access conditions are deemed to be either reasonably required or not reasonably required.</p> <p>The form of access condition may include, among other things, an upfront contribution, prepayment of all or part of an access facilitation charge or an additional take or pay arrangement (Paragraph 6.5.2(e)).</p> <p>The provisions also detail the requirements that Queensland Rail must comply with where additional revenue is earned as a result of applying access conditions, or if a new party comes to use the infrastructure built specifically for the original access seeker where Queensland Rail sought access conditions from that original access seeker in relation to that construction (Paragraphs 6.5.2(f) and (g)).</p> <p>Finally, subclause 6.5.3 states that the business will maintain an ‘Access Conditions Register’, of which the QCA may require an audit in accordance with a process agreed to by both Queensland Rail and the QCA.</p>	<p>The proposed AU1 does not include provisions equivalent to those in the Temporary Undertaking regarding “access conditions”.</p>	<p>The guiding principle for AU1 is to reduce the complexity of, and unnecessary detail in the Access Undertaking, and provide greater flexibility for Queensland Rail and access seekers to negotiate access terms and conditions appropriate for the particular circumstances of each system and access seeker.</p> <p>AU1 therefore does not include provisions regarding “access conditions” on the basis that such arrangements should be open to negotiation on a case-by-case basis with access seekers according to the specific requirements of the extension.</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<b>Reference Tariffs</b>		
<i>Summary</i>		
Reference tariffs are indicative access charges which apply to a reference train service. A reference train service is defined in an access undertaking by specific characteristics, including commodity carried, geographical scope (i.e. rail corridor of operation), and other features such as train length, axle load, speed and related factors. A reference tariff is typically established as part of the access undertaking process and applies only to reference train services.		
For the former QR Limited, reference tariffs were applied to defined reference train services operating in the Central Queensland Coal Network (CQCN) (referred to as the Central Queensland Coal Region in the Temporary Undertaking) and the West Moreton System (referred to as the Western System in the Temporary Undertaking). Following the re-structure of QR Limited, the West Moreton System is the only part of Queensland Rail's rail network to which a reference tariff for coal carrying train services applies. Otherwise, train services on Queensland Rail's network are not train services to which a reference tariff applies, and access charges for these services are determined through negotiation in accordance with the pricing principles.		
All clauses which relate specifically to the CQCN have therefore been removed from the proposed AU1. The following discussion regarding reference tariffs only considers proposed changes to reference tariff provisions which relate specifically to the West Moreton System.		
<p data-bbox="136 555 772 587"><i>Application and review of reference tariffs</i></p> <p data-bbox="136 595 772 707">Schedule F of the Temporary Undertaking includes details regarding the application of reference tariffs, including its period of effectiveness and how it may be reviewed (subclause 6.4.1 and 6.4.3).</p>	<p data-bbox="772 555 1422 611">The application and review of reference tariffs is provided in clause 3.4 of AU1.</p> <p data-bbox="772 619 1422 786">Clause 3.4.2(a) provides that the details regarding the effective period of the reference tariff and how the reference tariff may be reviewed are provided in Schedule A of AU1. This Schedule specifies a reference tariff will apply to reference train services on the West Moreton System.</p> <p data-bbox="772 794 1422 962">Clause 3.4.2(b) provides for Queensland Rail to review the existing reference tariffs and submit to the QCA a proposed new reference tariff prior to 30 June 2013 or such later date as approved by the QCA. Once approved by the QCA, the new reference tariffs are to take effect on and from 1 July 2013.</p> <p data-bbox="772 970 1422 1153">Further, where Queensland Rail does not submit a proposed new reference tariffs prior to 30 June 2013 (or such later date as approved by the QCA), the reference tariff in Schedule A of AU1, as adjusted in line with escalation parameters, will be taken to be submitted for the QCA's consideration under clause 3.4.2(b).</p>	<p data-bbox="1422 555 2192 722">Queensland Rail is proposing to initially postpone resetting the reference tariff for the West Moreton System. This has been proposed on the basis that this process, including the determination of an approved regulatory asset base (RAB) is complex, and the business would prefer to work with industry to agree the methodology and reference tariff, rather than seek QCA arbitration.</p> <p data-bbox="1422 730 2192 850">It is proposed that the existing reference tariff, set under the Temporary Undertaking, will continue to apply (adjusted in line with escalation parameters) for the purposes of submitting AU1 (the reference tariffs for AU1 are specified in Schedule A).</p> <p data-bbox="1422 858 2192 938">Queensland Rail will then submit a new reference tariff for the West Moreton System prior to 30 June 2013 (or at a later date where approved by the QCA) for the QCA's approval.</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Establishment of new reference tariffs</i></p> <p>The Temporary Undertaking includes provisions for the establishment of new reference tariffs.</p> <p>For example, in accordance with Paragraph 6.4.2(a), Queensland Rail must submit a proposed reference tariff for a new reference train service to the QCA:</p> <ul style="list-style-type: none"> <li>• if requested by the QCA where the QCA has a reasonable expectation that there is sufficient interest from access seekers to warrant the development of a reference tariff for a new reference tariff service (Paragraph 6.4.2(c)); or</li> <li>• where a new coal mine is developed and Train Services serving that mine will utilise Rail Infrastructure in the Western System (Paragraph 6.4.2(b)).</li> </ul>	<p>The proposed AU1 does not include provisions allowing for the establishment of reference tariffs for new reference train services.</p>	<p>Queensland Rail has a reference tariff in place for its West Moreton System, and currently there are no proposals to introduce a reference tariff for other systems.</p> <p>In past assessments of QR Limited's access undertakings the QCA determined an access undertaking should detail circumstances in which both QR Limited and the Authority can develop new reference tariffs and the processes to be followed.<sup>7</sup></p> <p>However, Queensland Rail has indicated that its customers have not called for the establishment of a reference tariff for other systems. It is also the case that the volume of throughput on these systems is currently below the tonnage threshold, and based on future projections over the proposed access period term this is unlikely to change over the term of AU1. Queensland Rail therefore considers that provisions for the establishment of new reference tariffs are not warranted. Accordingly, these provisions have not been included in AU1.</p> <p>Moreover, if during the term of the access undertaking Queensland Rail determines that a new reference tariff is required for a particular service or group of access seekers, it would be possible for the business to submit a draft amending access undertaking to seek QCA's approval of the proposed new reference tariff.</p> <p>This approach is consistent with the overriding objective of the access undertaking to remove unnecessary detail and reduce the overall complexity of the document for access seekers.</p>

<sup>7</sup> QCA. 2005. *Draft Decision: QR's 2005 Draft Access Undertaking July 2005*. Pg. 154

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Variation of reference tariffs</i></p> <p>Part A, Schedule F (Reference Tariff Schedules) of the Temporary Undertaking specifies the characteristics of the reference trains (e.g. commodity type, geographical scope, length, loading and unloading time). Part A also includes:</p> <ul style="list-style-type: none"> <li>provisions which allow reference tariffs to be varied following , among other things, an endorsed variation event, or at the written request of the QCA in specified circumstances; and</li> <li>a process for gaining QCA approval for such a variation.</li> </ul> <p>In addition, the Temporary Undertaking, under subclause 2.2.13 (Schedule F) requires that:</p> <p>(a) <i>a variation of a Reference Tariff submitted by [Queensland Rail] or developed by the QCA in accordance with this Clause 2.2 must include a review of System Allowable Revenue<sup>8</sup> and System Forecast<sup>9</sup> to the extent applicable to that variation; and</i></p> <p>(b) <i>the QCA in approving a variation of a Reference Tariff must also approve the corresponding variation of the applicable System Allowable Revenue and System Forecast.</i></p>	<p>The provisions regarding the variation of reference tariffs are largely consistent with the Temporary Undertaking. AU1 however does not include subclause 2.2.13 of the Temporary Undertaking.</p>	<p>The provisions regarding the variation of reference tariffs are largely consistent with the Temporary Undertaking, with the exception of subclause 2.2.13 (Schedule F), which has not been included.</p> <p>In line with the definition of System Allowable Revenue and System Forecast, subclause 2.2.13 in Part A of Schedule F in the Temporary Undertaking only applied to reference tariffs for the CQCN and did not apply to West Moreton System. Accordingly, these provisions are no longer relevant for the purpose of AU1.</p>

<sup>8</sup> Where System Allowable Revenue means (i) for AT<sub>2-4</sub> in relation to an individual Coal System Infrastructure, the total revenue from AT<sub>2-4</sub> arising from all Access Agreements in relation to that Individual Coal System Infrastructure that QR Network is entitled to earn over the relevant Year, as specified in Clauses 5.3, 6.3, 7.3 and 8.3, Part B of Schedule F; and (ii) for the AT<sub>5</sub> component of Access Charges for the Central Queensland Coal Region, the total revenue from the AT<sub>5</sub> component of Access Charges arising from all Access Agreements in relation to the Central Queensland Coal Region that QR Network is entitled to earn over the relevant Year, as specified in either Clause 5.3 or 6.3, Part B of Schedule F.

<sup>9</sup> Where System Forecast means the gtk [gross tonne kilometres] for the relevant Individual Coal System Infrastructure that is specified for the relevant Reference Train Service in part B of Schedule F.

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><i>Take or pay (TOP) provisions</i></p> <p>On 20 July 2011, Queensland Rail submitted a draft amending access undertaking (DAAU) to the QCA for the purpose of amending the TOP provisions in the Temporary Undertaking.</p> <p>This amendment was required to address two oversights which occurred following the introduction of the two-part tariff for the West Moreton System.</p> <p>The DAAU amended the Temporary Undertaking to include the AT<sub>2</sub> component of the reference tariff into the TOP calculation, which was initially not captured by the TOP calculation, and to amend the section of the formula applicable to the AT<sub>1</sub> (by dividing the gtk by 1000); a calculation which was omitted.</p> <p>On 27 October 2011, the Authority approved the DAAU. The amended provisions for calculating the TOP revenue (Subclause 5.3, Part C of Schedule F) states:</p> <p><i>The amount of Take or Pay invoiced in respect of a Year will be 80% of the amount calculated for that Year as follows:</i></p> $\left( \left( AT_1 \times \frac{gtk}{1000} \right) + AT_2 \right) * NTNO$ <p>where:</p> <p>(a) AT<sub>1</sub> and AT<sub>2</sub> are the values of the relevant Reference Tariff inputs applicable on the last day of the subject Year;</p> <p>(b) gtk is the nominal gtk for the relevant Train Service calculated using a nominal payload as determined by [Queensland Rail]; and</p> <p>(c) NTNO is the number of relevant individual Train Services that were entitled to operate during the subject Year in accordance with the relevant Train Service Entitlement, and did not operate (excluding Train Services that did not operate due to QR Network Cause),</p> <p><i>provided always that the amount of Take or Pay for the subject Year shall not be less than zero.</i></p>	<p>The proposed TOP provisions for AU1 (Clause 4(c), Schedule A) state:</p> <p>(c) The amount of the Take or Pay Charges for a Take or Pay Period will be the amount which is 80% of the amount calculated for that Take or Pay Period as follows:</p> $\left( \left( AT_1 \times \frac{gtk}{1000} \right) + AT_2 \right) * NTNO$ <p>where:</p> <p>(i) AT<sub>1</sub> and AT<sub>2</sub> are the Reference Tariff inputs applicable on the last day of that TOP Period;</p> <p>(ii) gtk is the average gtk for the relevant Train Services calculated using a nominal payload as determined by Queensland Rail (acting reasonably); and</p> <p>(iii) NTNO means the number of relevant individual Train Services that were entitled to be operated for the Take or Pay Period in accordance with the relevant Train Service Entitlement and did not operate (excluding Train Services that did not operate due to Queensland Rail Cause),</p> <p><i>provided always that the amount of Take or Pay Charges for a Take or Pay Period shall not be less than zero.</i></p>	<p>The proposed drafting of the TOP provisions for the proposed AU1 is materially the same as that approved by the QCA in October 2011, with only minor drafting variations.</p>

Temporary Undertaking	Proposed amendment to AU1	Discussion
<p><b><i>Regulatory Asset Base</i></b></p> <p>Schedule FB of the Temporary Undertaking include provisions regarding the maintenance of the regulatory asset base (RAB) for the CQCN, including roll forward provisions and the process for the approval of the business's asset management plan. These RAB provisions are linked to the determination of the reference tariff for the CQCN and are not related to the determination of the reference tariff for the West Moreton system.</p>	<p>For the proposed AU1, the provisions relating to the RAB, including the separate schedule, have been removed.</p>	<p>For the purposes of the proposed AU1, Queensland Rail is proposing to remove those sections which relate to the RAB on the basis that these provisions have no direct relationship to the reference tariff in place for the West Moreton system. The West Moreton System does not currently have a QCA endorsed RAB.</p> <p>Queensland Rail is proposing to re-set the reference tariff for the West Moreton system in 2013. This process may include determining an appropriate RAB for the system, along with determining a suitable WACC that is in line with the risk profile of the business. In line with this process, it is reasonable to defer any consideration of the RAB, including provisions regarding RAB maintenance and roll-forward to such time that a RAB has been set for the West Moreton system.</p>

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## 4 Conclusion

A guiding principle for AU1 is to develop an access undertaking that provides greater flexibility for Queensland Rail and access seekers to negotiate access terms appropriate for the particular circumstances of each system and access seeker.

Queensland Rail's proposed pricing principles provisions are largely consistent with the pricing principles in the Temporary Undertaking, which in turn are based on generally accepted regulatory principles. While there are differences between the pricing principles in the Temporary Undertaking and AU1, these differences reflect removal of redundant provisions or the simplification of detailed provisions which are no longer appropriate following changes to the business' structure and operations.

## Appendix A Ceiling revenue limit

### Temporary Undertaking

The Revenue Limit is defined by the Temporary Undertaking as (Paragraph 6.2.4(a)):

- (a) *The Revenue Limit will be determined as the maximum amount of expected revenue, including:*
- (i) *Access revenue (determined consistent with Paragraph 6.2.3(c)) that may be earned from Access Charges; and*
  - (ii) *where the Individual Train Service or combination of Train Services (as appropriate) includes all of the Train Services using a section of the Rail Infrastructure, any Transport Services Payments towards the relevant section of Rail Infrastructure,*

*over the Evaluation Period, measured such that the net present value of the cashflows associated with providing Access for the Individual Train Service or the combination of Train Services (as appropriate) over the Evaluation Period is zero. This measurement can be expressed as:*

$$0 = -AV_0 + \sum_{t=1}^n \frac{(RL_t - C_t - M_t - T_t)}{(1+ROA)^t} + \frac{AV_n}{(1+ROA)^n}$$

*where:*

**AV<sub>0</sub>** *is the value of assets reasonably expected to be required for the Stand Alone provision of Access for the Train Service(s), assessed in accordance with Paragraph 6.2.4(c), at the commencement of the Evaluation Period;*

**n** *is the number of years in the Evaluation Period;*

**t** *is each year within the Evaluation Period from 1 to n;*

**RL<sub>t</sub>** *is the Revenue Limit for the Train Service(s) expressed as revenue that may be earned in each year of the Evaluation Period;*

**C<sub>t</sub>** *is the capital expenditure for assets reasonably expected to be required for the Stand Alone provision of Access for the Train Service(s) in each year of the Evaluation Period;*

**M<sub>t</sub>** *is the Efficient Cost, including operating and maintenance costs, business and corporate overheads and QCA Levy, reasonably expected to be incurred for the Stand Alone provision of Access for the Train Service(s) in each year of the Evaluation Period;*

**ROA** *is the maximum allowable rate of return expressed in nominal post tax terms (with the cost of debt expressed on a before tax basis), as agreed by [Queensland Rail] and the QCA or, failing such agreement, as determined by the QCA;*

**T** *is the tax expense assessed through the application of the statutory tax rate for corporations to the taxable income reasonably expected to be earned through the Stand Alone provision of Access for the Train Service(s) in each*

year of the Evaluation Period, where such tax expense is reduced in each year by the application of the gamma factor, reflecting the market value of dividend imputation, as agreed by [Queensland Rail] and the QCA or, failing such agreement, as determined by the QCA; and

$AV_n$  is the value of assets reasonably expected to be required for the Stand Alone provision of Access for the Train Service(s), assessed in accordance with Paragraph 6.2.4(c), at the end of the Evaluation Period.

## Proposed AU1

The Ceiling Revenue Limit is defined by AU1 as (Clause 3.2.3(a)):

- (i) the maximum amount of Expected Access Revenue; and
- (ii) where the Access Seeker's proposed Train Services comprise all of the Train Services using the relevant part of the Network, the Transport Services Payments (if any) that are reasonably expected to be received by Queensland Rail in respect of that part of the Network (on a pro rata basis for that individual Train Service or combination of Train Services, as applicable),

over the Evaluation Period where the Ceiling Revenue Limit is measured such that the net present value of the cashflows associated with providing Access for the relevant Train Service(s) over the Evaluation Period is zero. This measurement can be expressed as:

$$0 = -AV_o + \sum_{t=1}^n \frac{(CRL_t - C_t - M_t - T_t)}{(1 + WACC)^t} + \frac{AV_n}{(1 + WACC)^n}$$

where:

$AV_o$  is the value of assets reasonably expected to be required for the Stand Alone provision of Access for the Train Service(s), assessed in accordance with clause 3.2.3(c), at the commencement of the Evaluation Period;

$n$  is the number of years in the Evaluation Period from one to  $n$ ;

$t$  is each year within the Evaluation Period;

$CRL_t$  is the Ceiling Revenue Limit for the Train Service(s) expressed as revenue that may be earned in each year of the Evaluation Period;

$C_t$  is the capital expenditure for assets reasonably expected to be required for Stand Alone provision of Access for the Train Service(s) in each year of the Evaluation Period;

$M_t$  is the Efficient Costs for the Stand Alone provision of Access for the Train Service(s) in each year of the Evaluation Period;

$T$  is the tax expense assessed through the application of the statutory tax rate for corporations to the taxable income reasonably expected to be earned through the Stand Alone provision of Access for the Train Service(s) in each year of

*the Evaluation Period, where such tax expense is reduced in each year by the application of the gamma factor, reflecting the market value of dividend imputation, as agreed by Queensland Rail and the QCA or, failing such agreement, as determined by the QCA; and*

**AV<sub>n</sub>** *is the value of assets reasonably expected to be required for the Stand Alone provision of Access for the Train Service(s) assessed in accordance with clause 3.2.3(c), at the end of the Evaluation Period.*

**WACC** *has the meaning given to that term in clause 7.1*

Relevant definitions from AU1 include:

**Margin** *means a rate of 4.77%, being the difference between the WACC as at the Approval Date and the risk free rate component of the WACC, expressed as a positive value;*

**Undertaking Risk Free Rate** *means the rate calculated:*

- (a) *by averaging the yield on a five year Commonwealth Government Bond over a 20 trading day period ending as close as practicable to but not later than the date that Queensland Rail offers an Access Agreement to an Access Seeker; and*
- (b) *in accordance with:*
  - (i) *the methodology used by the QCA to determine the yield on such a Commonwealth Government Bond; or*
  - (ii) *where paragraph (b)(i) of this definition does not apply, the methodology agreed between Queensland Rail and the QCA (acting reasonably) from time to time for the purpose of this definition;*

**WACC** *means the weighted average cost of capital which:*

- (a) *as at the Approval Date, means a rate of 9.96% nominal post-tax; and*
- (b) *after the Approval Date, means a rate equivalent to the Undertaking Risk Free Rate plus the Margin.*