Statement of Issues

6 October 2016

Aurizon – proposed acquisition of GRail
Pacific National – proposed acquisition of GRail

Purpose

1. This Statement of Issues sets out the Australian Competition and Consumer Commission's (**ACCC**'s) preliminary views on competition issues arising from two separate proposals to acquire certain assets and interests of Glencore Rail (NSW) Pty Ltd (**GRail**), which are being sold through a competitive bid process. One is a proposed acquisition by Aurizon Operations Ltd (**Aurizon**) and the other is a proposed acquisition by Pacific National Pty Ltd (**PN**).

2. The proposed acquisitions raise the same or similar competition issues and their review timelines are currently aligned, so the ACCC is releasing a combined Statement of Issues for both proposed acquisitions.

3. This Statement of Issues:

- identifies areas of further inquiry
- gives all interested parties an opportunity to comment
- invites interested parties to submit information to assist us in our assessment of the issues.

Overview of ACCC's preliminary views

4. The legal test which the ACCC applies in considering the proposed acquisitions is in section 50 of the *Competition and Consumer Act 2010*. Section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.

5. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'.

6. The ACCC has identified an issue that may raise concerns for both proposed acquisitions. The issue which may raise concerns is that, in the absence of the proposed acquisitions, a third competitor may enter the market for the provision of coal haulage services in the Hunter Valley via the acquisition of GRail and provide a strong competitive constraint on Aurizon and PN.

7. Unless otherwise specified, all of the preliminary analysis contained in this Statement of Issues applies equally to both proposed acquisitions.

Making a submission

8. The ACCC is seeking submissions from interested parties, particularly on the following key issues:

- the significance of GRail as a potential platform for entry and subsequent expansion in competition with Aurizon and PN
- the intensity of competition between Aurizon and PN
- the prospect of customers sponsoring the entry of new haulage providers.

9. Interested parties should provide submissions by no later than 5pm on 21 October 2016. Responses may be emailed to mergers@accc.gov.au with the title: Submission re: GRail - attention John Rouw/Stella Leung. If you would like to discuss the matter with ACCC officers over the telephone or in person, or have any questions about this Statement of Issues, please contact John Rouw on (03) 9290 1402 or Stella Leung on (03) 9658 6444.

10. The ACCC anticipates making a final decision for both matters on 15 December 2016, however, these timelines can change and may not remain aligned. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.

Confidentiality of submissions

11. The ACCC will not publish submissions regarding the proposed acquisitions. We will not disclose submissions to third parties (except our advisors / consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the *Competition and Consumer Act 2010*. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, if the information provided to the ACCC is of a confidential nature, please indicate as such. Our *Informal Merger Review Process Guidelines* contain more information on confidentiality.

About ACCC 'Statements of Issues'

12. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.

13. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide interested parties with the basis for making further submissions should they consider it necessary.

Timelines

Review of proposed acquisition by Aurizon

Date	Event
4 August 2016	ACCC commenced review of the proposed acquisition by Aurizon
30 August 2016	ACCC revised the provisional decision date from 29 September to 6 October due to a delay in Aurizon providing requested information.
6 October 2016	ACCC publication of Statement of Issues
21 October 2016	Deadline for submissions from interested parties in response to this Statement of Issues
15 December 2016	Proposed date for ACCC final decision

Review of proposed acquisition by Pacific National

Date	Event
15 August 2016	ACCC commenced review of the proposed acquisition by PN
6 October 2016	ACCC publication of Statement of Issues
21 October 2016	Deadline for submissions from interested parties in response to this Statement of Issues
15 December 2016	Proposed date for ACCC final decision

The parties

The proposed acquirers

Aurizon

14. Aurizon provides a range of rail haulage services, including for coal, iron ore and bulk freight. It also operates a ‘below rail’ business in Queensland (the Central Queensland Coal Network). Aurizon provides coal haulage services in the Hunter Valley region in NSW and in Queensland. Aurizon has been operating in the Hunter Valley since 2005, when it commenced haulage operations for a subsidiary of BHP Billiton. It has since expanded to hold about a quarter of Hunter Valley market share, by coal tonnages.

Pacific National

15. PN provides a range of rail haulage services, including for coal, grain, minerals, concentrate and construction materials. PN was created in 2002 when Toll Holdings and Patrick Corporation purchased the Government-owned FreightCorp and National Rail businesses. FreightCorp was the incumbent coal hauler in the Hunter Valley. PN is currently the largest coal hauler in the Hunter Valley and also provides coal haulage in other regions of NSW and in Queensland, which it entered in 2009/10 through contracts with Rio Tinto and Glencore.

The vendor

Glencore Coal

16. Glencore Coal Pty Ltd (**Glencore Coal**) has coal mining operations in Queensland and NSW. It is the largest coal producer in NSW. Its mines in the Hunter Valley are located off the following sub-sections of the Hunter Valley Rail Network:

- Muswellbrook-Newcastle Line – Bulga, United, Ravensworth, Liddell and Mt Owen mines
- Ulan Line – Mangoola and Ulan mines.

The target

GRail assets and interests

17. Through its subsidiary, Glencore Rail (NSW) Pty Ltd, Glencore Coal owns rolling stock, specifically, nine trains comprising 30 locomotives and 894 wagons. These trains are operated by Genesee & Wyoming Australia Pty Ltd (**GWA**) through its subsidiary, Freightliner Australia Coal Haulage Pty Ltd, under a Framework Agreement between GWA and Glencore Coal expiring at the end of 2020.[1] GWA, on GRail's behalf, hauls the majority of Glencore Coal's Hunter Valley production. Glencore Coal's remaining haulage requirements are contracted to PN.

18. These assets and related arrangements resulted from a 2009 decision by Xstrata Coal (the precursor to Glencore Coal) to invest in its own rolling stock in the Hunter Valley, naming the operation "X-Rail". According to Xstrata, it invested directly into the Hunter Valley coal chain in order to provide greater security of supply for its customers.[2] Since then, Xstrata, and then Glencore Coal, has incrementally expanded the volume of coal hauled by its rolling stock fleet and the size of its fleet.

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[1] The GRail purchaser will have an option to extend this contract for a further five years.
[2] The Australian, *Xstrata shunts Asciano with its own trains*, 25 September 2009, http://www.theaustralian.com.au/business/mining-energy/xstrata-shunts-asciano-with-its-own-trains/story-e6frg9df-1225779315649?nk=0776584c511ef7fce687c3976fd7b895-1474355765

19. Glencore Coal is now offering for sale certain assets and interests of Glencore Rail (NSW) Pty Ltd (together, **GRail**), including:

- **Trains**: Nine trains, comprised of 30 locomotives and 894 wagons.

- **A haulage contract**: A 20-year rail haulage agreement (comprising Take or Pay and exclusivity periods) pursuant to which the purchaser of GRail will be required to provide coal rail haulage services from specified Glencore Coal mines to the Port of Newcastle under specified tariff structures. Volumes could be hauled by competitors where the GRail purchaser cannot meet the demand from Glencore Coal and where the GRail purchaser does not meet contractually required performance standards.

- **Rights to further tonnes**: A right of first refusal for additional tonnes to be hauled (an 'Exclusivity Component'). Where the GRail purchaser does not exercise its right of first refusal to haul the additional coal, Glencore Coal is free to appoint a third party rail haulage provider to haul that coal.

- **Operator arrangements**: A contractual requirement to continue to engage the train operations services of GWA until 31 December 2020 under specific contract terms and pricing agreed with Glencore Coal. The GRail purchaser will have an option to extend this contract for a further five years.

- **Service arrangements**: A contractual requirement to utilise maintenance and provisioning services from UGL Limited until 31 December 2020.

Industry background

Coal industry in Australia

20. Coal is Australia's second-largest export commodity after iron ore, with around two-thirds or more of annual coal production shipped overseas.[3] Australia's largest markets for coal are Japan, China, Korea, India and Taiwan.[4]

21. There are two types of coal produced in Australia: black coal and brown coal. Black coal is mined in Queensland and New South Wales with the majority exported overseas, while the lower-quality brown coal is mined almost exclusively in Victoria where it is used locally in power generation.[5]

22. Black coal can be classified into two types: thermal (or steaming) and metallurgical (or coking). Thermal coal is used to fuel electricity generation, while metallurgical coal is used with iron ore in making steel. Australia is the world's

[3] Australian Government Department of Foreign Affairs and Trade, *Australian Composition of Trade 2015*, p. 4.
[4] Australian Government Department of Industry, Geoscience Australia, Bureau of Resources and Energy Economics, *Australian Energy Resource Assessment* 2nd Ed 2014, chapter 5.
[5] Ibid.

leading exporter of coking coal, and the second largest exporter of thermal coal, behind Indonesia.[6]

23. The Hunter Valley coal network in NSW largely produces thermal coal. The Australian Government Department of Industry is forecasting a slight decline in thermal coal export volumes in 2016-17 and persistent low prices.[7]

Hunter Valley coal supply chain

24. The Hunter Valley coal network is the largest coal supply chain in the world. In 2016, around 190 million tonnes of coal are contracted for export.[8]

25. The network is spread over a large area, with coal transported distances of up to 380 kilometres.[9] Almost all coal from the Hunter Valley coal network is transported over the Australian Rail Track Corporation's (**ARTC**'s) Hunter Valley Rail Network, with a small percentage, usually short-haul loads close to port, being carried by truck.

26. ARTC's demand projections indicate that in the next five years, prospective volumes are likely to arise along the Gunnedah Basin Line.[10]

27. There are 12 coal producers operating in the Hunter Valley region.[11] Between them, the producers operate around 30 active mines, with a number of additional mines in the region not in production.

28. Producers transport their coal to port over the Hunter Valley Rail Network by entering into:

- haulage agreements with an 'above-rail' operator
- 'below-rail' agreements with ARTC for access to the track.

29. Most coal is delivered to the Port of Newcastle, where it is loaded onto ships and transported to end-users. In the case of export markets, coal producers enter into access arrangements with the port terminal operators. The two port terminal operators are:

- Port Waratah Coal Services, which operates the world's largest coal terminal facilities (Kooragang and Carrington), with a combined shiploading capacity of 145 million tonnes per annum (**mtpa**)[12]

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[6] Ibid.
[7] Australian Government Department of Industry, *Resources and Energy Quarterly June 2016*, p. 43.
[8] Australian Rail Track Corporation, *2016-2025 Hunter Valley Corridor Capacity Strategy – Consultation Draft*, August 2016, p. 4.
[9] Hunter Valley Coal Chain Coordinator (HVCCC) website, https://www.hvccc.com.au/AboutUs/Pages/History.aspx
[10] See above n 8, Tables 4 and 5, pp. 28-29 and Figure 19, p. 33.
[11] The coal producers are: Glencore Coal, Coal & Allied (Rio Tinto Coal Australia), Whitehaven, Hunter Valley Energy Coal Pty Ltd (BHP Billiton), Yancoal Australia, Peabody Energy, Bengalla Mining Company, Idemitsu Australia Resources, MACH Energy (not yet in production), Centennial Coal, Anglo American and The Bloomfield Group.

- Newcastle Coal Infrastructure Group, which has a shiploading capacity of 66 mtpa.[13]

30. The remaining coal is delivered to power stations in the Hunter Valley.

31. The supply chain currently has a total capacity of 208 mtpa,[14] and loads more than 1400 vessels from the Port of Newcastle per year.[15]

32. The supply chain is centrally coordinated by the Hunter Valley Coal Chain Coordinator (**HVCCC**) to ensure that the network is being used in the most efficient way. The HVCCC is responsible for the daily co-ordination of haulage and planning to ensure that the long-term capacity requirements of users are met.[16]

Coal haulage contracts in the Hunter Valley

33. Generally, haulage contracts between coal producers and haulage providers include a 'take or pay' component (a fixed amount regardless of whether the coal producer uses the haulage service for nominated volumes) and may include exclusivity arrangements (for example, where the coal producer must first offer the contracted haulage provider any additional volumes for transport).

34. Many of the current haulage contracts for the Hunter Valley region were executed around 2010-11, and are generally for a term of around seven to 10 years (commonly referred to as 'long-term' contracts). Some contracts include an option for extension or renewal (for example, for an additional five-year period).

35. There is also a market for 'spot' or 'surge' tonnes (rather than a specified annual haulage volume). These contracts may be for a one-year term.

Future with and without the acquisition

36. Section 50 of the Act prohibits mergers or acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in a market. In assessing a proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment post-acquisition if the acquisition proceeds (the "with" position) to the likely future competitive environment if the acquisition does not proceed (the "without" position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.

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[12] Port Waratah Coal Services website, http://pwcs.com.au/who-we-are/about-us/
[13] Newcastle Coal Infrastructure Group website, http://www.ncig.com.au/Home/CompanyOverview/tabid/134/Default.aspx
[14] This is the current terminal capacity at the Port of Newcastle. See above n 8, p. 9.
[15] See above n 9, https://www.hvccc.com.au/AboutUs/Pages/MapOfOperationsV3.aspx
[16] Ibid, https://www.hvccc.com.au/AboutUs/Pages/History.aspx

37. Glencore Coal is offering GRail for sale through a competitive bid process. The ACCC is therefore assessing each of the proposed acquisitions on the basis that, in the likely future without it, a party other than Aurizon or PN will acquire GRail (an **Alternative Purchaser**). This involves a comparison between:

- in the future without either of the proposed acquisitions, a market of three competitors (Aurizon, PN and an Alternative Purchaser)
- in the future with either of the proposed acquisitions, a market of two competitors (Aurizon and PN).

38. In particular, the ACCC is assessing the proposed acquisitions against an Alternative Purchaser that does not have any other coal haulage operations in the market and would be a potential competitor to Aurizon and PN for other Hunter Valley coal haulage contracts.

Market definition

39. The ACCC's preliminary view is that the relevant market for assessing the competitive effects of the proposed acquisitions is the provision of coal haulage services in the Hunter Valley, being coal haulage services supplied to coal producers and other customers on the Hunter Valley Rail Network. This is because:

- The assets and interests constituting GRail together provide coal haulage for Glencore Coal on the Hunter Valley Rail Network. Aurizon and PN also provide coal haulage services on the Hunter Valley Rail Network. Given the assets and interests involved, the provider of coal haulage services to Glencore Coal in the Hunter Valley (Aurizon, PN or an Alternative Purchaser) is likely to be relevant to the competitive constraints when other Hunter Valley coal haulage contracts are up for tender in the future.
- Providers of coal haulage in other regions and haulage of other commodities may provide some level of competitive constraint for future coal haulage contracts in the Hunter Valley. However the extent of this constraint is likely to be significantly weaker than that imposed by a haulage operator already active in the Hunter Valley using its own rolling stock. It would take time and significant investment for rail haulage operators based in other regions or hauling other commodities to start hauling coal on the Hunter Valley Rail Network. In particular, the infrastructure of the Hunter Valley Rail Network can support heavy, high-capacity trains that are not used elsewhere. Rolling stock used elsewhere or for other commodities may be capable of running on the Hunter Valley Rail Network, but it may require costly modifications and would generally be less cost-effective than the existing rolling stock used there.

The ACCC invites comments from market participants on its preliminary views about the definition of the relevant market.

Issue that may raise concerns: Preventing the entry of a third competitor

40. Based upon its inquiries to date, the ACCC's preliminary view is that each of the proposed acquisitions may substantially lessen competition because in the future without the proposed acquisitions, an Alternative Purchaser may establish itself as a third competitor in the market by acquiring GRail.

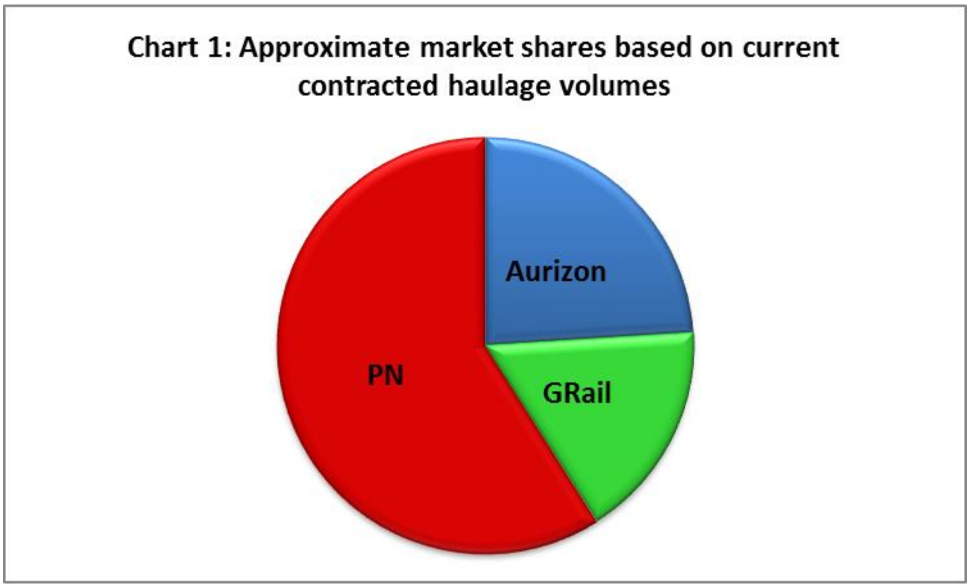
41. Market participants consider that competition in the market would be enhanced if a third competitor entered the market by acquiring GRail. They have identified a number of features of the market that mean the proposed acquisitions would give rise to competition concerns, including the uniqueness of the GRail package of interests and assets for a new entrant, although a range of views have been expressed on some points.

42. The ACCC is continuing to consider, and invites feedback particularly on whether:

- the presence of a 'third competitor' beyond Aurizon and PN would have a significant effect on the intensity of competition in the Hunter Valley coal haulage market
- GRail in particular would be significant as a platform for entry and subsequent expansion for someone to compete with Aurizon and PN for other haulage contracts
- Aurizon and PN will compete intensely even if one of them acquires GRail
- the threat of new entry, potentially sponsored by customers, is and would remain a strong competitive constraint even if Aurizon or PN acquires GRail.

Market concentration

43. PN is estimated to be hauling the majority of coal currently in the Hunter Valley: over half of total contracted volumes. Aurizon is estimated to be hauling about a quarter of total contracted volumes, with GRail hauling the remaining volumes. This is shown in **Chart 1** below.



44. GRail does not compete for haulage contracts in the Hunter Valley. It exclusively services Glencore Coal. Whether GRail would effectively become a third competitor in the market in future depends on the identity of the acquirer.

45. A fourth rail haulage business, Southern Shorthaul Railroad (**SSR**), also uses the Hunter Valley Rail Network. However its customer for these haulage tasks, Centennial Coal, is based on the Sydney Trains Network. SSR only uses seven kilometres of the Hunter Valley Rail Network, so that it can access the Port of Newcastle from the Sydney Trains Network.[17] It runs lighter trains suited to the Sydney Trains Network and does not provide haulage to any coal producers that are based on the Hunter Valley Rail Network. Market participants therefore do not regard SSR as a competitor in the supply of coal haulage services in the Hunter Valley.

Intensity of competition and the significance of a third competitor

46. The ACCC's preliminary view is that, if either of the proposed acquisitions proceeds, there will be only two active competitors in the market, as opposed to the likelihood of a third competitor in the market in the absence of the proposed acquisitions.

47. In this context, the ACCC continues to consider the key questions:

- How intense is competition between Aurizon and PN?
- What effect, if any, might an Alternative Purchaser have on the intensity of competition in the market?

[17] Centennial Coal, *Submission to ACCC consultation paper on ARTC's 2016 Hunter Valley Access Undertaking*, 8 March 2016, p. 1.

Intensity of competition between Aurizon and PN

48. The ACCC has received mixed feedback on the intensity of competition between Aurizon and PN. Some market participants have described the level of competition between Aurizon and PN as a 'cosy duopoly' or similar. On the other hand, feedback from some other participants suggests that they are motivated to compete vigorously because, for example, there is significant cost to losing a contract and having the associated rolling stock stranded.

The ACCC invites comments from market participants on the intensity of competition between PN and Aurizon. Please provide examples wherever possible to illustrate your answers.

For example:

- On what parameters do Aurizon and PN compete? Are their offerings differentiated? How strongly do they compete on price? How strongly do they compete on performance (including cycle times, flexibility and/or reliability)? How strongly do they compete on rolling stock specifications or quality?
- Do Aurizon and PN compete more intensely in certain circumstances? Do Aurizon and PN compete more intensely for 'new' or spot tonnes, larger customers or in particular regions such as the Gunnedah Basin?
- If you are a customer, have you switched providers? Why? If not, why not?
- How do customers in the Hunter Valley encourage or take advantage of competition between Aurizon and PN? How might they 'play one off against the other'?
- What effect did Aurizon's entry to the Hunter Valley have on PN's approach to the market?

Significance of a third competitor

49. The ACCC is considering the significance of an Alternative Purchaser competing in the market.

50. Market participants have frequently commented that GRail would provide a strong platform for expansion if acquired by an Alternative Purchaser.

51. The ACCC is taking into account the historical examples of entry and expansion into full-service coal haulage (providing rolling stock and operator services), by Aurizon into NSW in 2005 and PN into Queensland in 2009/10.

52. Market participants have indicated that:

    - An Alternative Purchaser would face lower barriers to expansion compared to the barriers facing new entrants when tendering for future long-term haulage contracts, because it would have an established fleet of rolling stock servicing a major customer in the Hunter Valley. This could make it more efficient and flexible in servicing other coal producers, and therefore a stronger competitive constraint on Aurizon and PN than the threat of new entry.

- The 20-year rail haulage agreement with Glencore Coal would provide a basis for an Alternative Purchaser to be an active competitor in the market in the long term, including by establishing centralised provisioning and light maintenance facilities.

53. The ACCC is continuing to consider how the potential competitive constraint from an Alternative Purchaser owning the GRail assets and interests would compare with the constraint that Aurizon and PN would impose on each other and the constraint from the threat of new entry.

The ACCC invites comments from market participants on the significance to competition in the market of having a competitor beyond Aurizon and PN; and of the significance of GRail as a platform for expansion in competition with Aurizon and PN.

The ACCC particularly invites detailed comments on the following:

- How material to the competitive process would a third active competitor for coal haulage in the Hunter Valley be to competition for a coal producer's business? Are there any examples of a third competitor entering a market for rail haulage elsewhere in Australia and having a significant impact on competition in the relevant markets?

- Will an Alternative Purchaser be able to use any of the GRail assets and interests, including rolling stock and/or operator, provisioning and maintenance arrangements, as a platform for expansion? If yes, please identify the specific components and attributes of the GRail assets and interests that might put an Alternative Purchaser in a strong competitive position.

- Is it correct that a coal hauler already operating a fleet in the market may be able to win a haulage contract without acquiring new rolling stock or without having to acquire as much new rolling stock as a new entrant?

- What, if anything, do the introductions of Aurizon and/or GRail in to Hunter Valley coal haulage and/or PN into Queensland coal haulage demonstrate or indicate about the likely impact in the Hunter Valley coal haulage market of an Alternative Purchaser acquiring GRail?

Barriers to entry

54. The ACCC is considering the competitive constraint imposed by potential new entrants and is therefore considering the significance of any barriers to entry to the Hunter Valley coal haulage market.

55. Based on market feedback, the ACCC's preliminary view is that barriers to entry in this market are high. Market participants have identified the following key barriers to entry.

Rolling stock

56. It appears that new entrants generally need to undertake significant capital investments in rolling stock to be able to provide coal haulage services to customers on the Hunter Valley Rail Network. As explained above, coal haulers

on the Hunter Valley Rail Network often use heavy, high-capacity trains and configurations not routinely used elsewhere. In particular:

- The Hunter Valley Rail Network is standard gauge and the coal locomotives are diesel-fuelled, meaning that rolling stock from some other regions would need substantial modification, which may not be cost-effective. For example, the coal haulage networks in Queensland are narrow gauge and the coal locomotives there are often electric.

- Coal wagons are specifically designed to load and unload coal, and wagons designed to haul other commodities, such as grain, would require modification to be suitable for this purpose, which may not be a cost-effective option.

- While technically any standard gauge rolling stock could operate on the Hunter Valley Rail Network, it is possible to run heavier trains there. As a result, the most cost-effective train configurations running on the Hunter Valley Rail Network involve different locomotives and wagons, in different combinations, to those used for haulage tasks elsewhere. Some locomotives and wagons used on the Hunter Valley Rail Network may be "captive" to that network.

57. The ACCC understands from market inquiries that there is not an active market for second-hand rolling stock used in the Hunter Valley and that the option of leasing may not be available or cost-effective for an entire fleet operating in the Hunter Valley, so a new entrant would need to acquire new rolling stock and would risk being unable to recoup any of its investment if it sought to exit the market later. A typical train operating on the Hunter Valley Rail Network would cost in excess of $25 million, with additional costs required for spare rolling stock to allow for maintenance and outages. The number of trains required would depend on factors such as the volume of coal to be hauled.

58. In this context, the ACCC understands that no party would acquire rolling stock for use on the Hunter Valley Rail Network unless it had already secured a long-term contract to off-set the associated stranding risk. Aside from spot haulage contracts, typical haulage contracts in the Hunter Valley have a duration of around seven to 10 years. Rolling stock used on the Hunter Valley Rail Network typically has an expected life of about 30 years, and it can be longer. This means that a significant stranding risk remains even after a coal hauler wins a contract with a coal producer.

59. In addition, there are limited haulage contracts available in total, meaning that it could be a matter of years before stranded rolling stock is able to be deployed elsewhere in the Hunter Valley.

60. The lead time for new rolling stock can be up to two years, meaning that a new entrant only has a realistic opportunity to secure a haulage contract if a coal producer allows sufficient time in its tendering process, which has not always been the case.

Scale and scope advantages

61. Market inquiries have indicated that there are significant competitive advantages, based on scale and scope advantages, from having larger established train fleets and a large range of customers in the Hunter Valley. For example, it appears that:

- A large operator's overall utilisation levels of rolling stock can be higher, because the necessary spare locomotives and wagons (to cover breakdowns and heavy maintenance) may be a smaller proportion of their rolling stock fleet.

- It provides more flexibility in completing rail tasks and dealing with delays and malfunctions, improving the overall reliability of that coal hauler.

- A coal hauler may be able to win a haulage contract without acquiring new rolling stock or without having to acquire as much new rolling stock as a new entrant.

Reputation

62. Haulage is a critical input for coal producers. Any delays or problems in delivering coal to the Port of Newcastle can have a very significant impact on producers. This means that coal producers place a high value on the demonstrated reliability of the coal hauler, ideally supported by a demonstrated commitment to remain in the Hunter Valley and maintain support for its fleet there. New entrants may be able to demonstrate relevant experience hauling outside the Hunter Valley. However, it appears that is not weighted as highly as having an established track record in the Hunter Valley.

Provisioning

63. It is critical for haulers to have or have access to provisioning facilities. That is, facilities to load rolling stock with fuel, oil and sand.

64. Haulers can use trucks for provisioning or establish fixed provisioning infrastructure. It appears that haulage providers have entered new regions using trucks for provisioning, but only for a limited period before establishing fixed facilities. Market inquiries indicate that the two main fixed options are establishing:

- a central provisioning facility near the Port of Newcastle, as PN has done at Greta and Aurizon has done at Hexham. Such a facility is likely to involve significant investment

- facilities on a coal producer's mine loops, which may be more feasible for a new entrant than a large central facility. However, a coal producer needs to be amenable to potential disruptions to its loading operations on its loops. In addition, there are likely to be commercial or practical obstacles to using those facilities for trains serving other coal producers.

65. Market feedback on the importance and difficulty of establishing cost-effective, efficient and competitive provisioning facilities has been mixed.

Other potential barriers

66. **Rolling stock maintenance**: The need to have or have access to facilities for heavy maintenance of rolling stock has been raised by some market participants as a key barrier to entry. However, other market participants have suggested that this is not a major issue, primarily on the basis that it can be obtained from third parties.

67. **Train driver availability**: Scarcity of qualified and trained drivers has been identified by some market participants as a key barrier to entry. However, other market participants do not consider that recruiting drivers is problematic.

68. **Regulatory requirements**: Regulatory requirements, such as operator accreditation, do not appear to be a significant barrier to entry. However, the ACCC has received some market feedback that it takes time and cost to obtain accreditations, licences and agreements and that the accreditations and licences need to be in place before an operator could bid for new tasks.

The ACCC invites comments from market participants on its preliminary view that barriers to entering the market for the provision of coal haulage services in the Hunter Valley are high. Please provide examples wherever possible to illustrate your answers.

For example:

- Is appropriate rolling stock readily available, new or second hand, purchased or leased? Do the lead-times for obtaining rolling stock, and the risk that the rolling stock will be stranded at the end of a contract, heighten the level of the barriers to entry?

- Can and do bigger fleets have better utilisation rates, flexibility and/or redundancy?

- What are the implications, if any, for a haulage operator's competitiveness of the various provisioning arrangements it can put in place?

- Please comment on whether maintenance, driver availability, regulatory requirements or any other issues are significant barriers to entry in this market.

Countervailing power

69. Another key question that the ACCC is continuing to consider is the level of competitive constraint imposed by the threat of customers exercising countervailing power against Aurizon and PN. In particular, the ACCC is considering the likelihood of coal producers sponsoring the entry of new haulage providers or acquiring their own rolling stock as an alternative to acquiring haulage services from Aurizon or PN. If this would be a real threat following either of the proposed acquisitions, then the loss of the potential competitive constraint of an Alternative Purchaser in the market may be less significant.

70. The ACCC notes that coal producers are generally well-resourced, sophisticated parties. This means they are well-placed to exercise any countervailing power that they might have in commercial negotiations with coal haulers.

71. In particular, there is scope for coal producers to structure their tendering practices to facilitate new entry by, for example, allowing enough lead time for new entrants to acquire rolling stock and by accommodating proposals to construct provisioning facilities on their mine loops.

Self-supply of rolling stock

72. Coal producers can also acquire rolling stock and engage a third party to operate it, as has occurred most notably with Glencore Coal. However, market participants have highlighted that there are limited circumstances in which a coal producer will decide to invest in its own rolling stock, considering that this is not a core business activity; and the risk profile and required rates of return differ significantly from coal production. It has also been put to the ACCC that any decision by a coal producer to acquire rolling stock is more likely to be a means to reduce operational risk in the supply chain, rather than acting as a competitive constraint on haulage providers. This is most likely to arise when demand for haulage is growing and network capacity is constrained.

Sponsoring new entry

73. The ACCC has received mixed views on the likelihood of coal producers seeking to facilitate new entry in the future. The ACCC is considering the likelihood of other coal producers sponsoring entry in future. The ACCC is considering the following:

- Parties have cited to the ACCC various historical examples of customers in Australia introducing a new haulage provider to an area or of acquiring (and in some cases operating) their own rolling stock.
- In the Hunter Valley, there has only been one significant example of a new coal hauler establishing a presence. This new entrant (Aurizon) was the incumbent haulage provider in Queensland, and its entry was mirrored by PN's entry into Queensland. In this sense, the expansion of NSW and Queensland incumbents into each other's states has now occurred, and further new entry appears less likely.

74. In considering the likelihood and significance of a third competitor entering the market, the ACCC has noted:

- The Glencore Coal contract, which is for the largest coal producer in the market, meets or exceeds the minimum efficient scale for entry to the market. Other haulage contracts on offer in the Hunter Valley in future may not provide that scale.
- The Glencore Coal haulage contract is for a longer duration than typical haulage contracts for Hunter Valley customers, and is therefore likely to offer greater commercial certainty to an Alternative Purchaser than would be provided to a new entrant providing haulage to other customers in the Hunter Valley.
- The GRail package includes a fleet of rolling stock sufficient to meet all of the customer's current haulage requirements, and which has already serviced the customer for a number of years. In addition, there may be

spare capacity in the nine trains Glencore Coal is divesting (capacity beyond Glencore Coal's apparent current needs), such that it would be possible to service other coal producers besides Glencore Coal with this rolling stock. This may facilitate immediate competition for short-term or ad hoc haulage contracts, potentially using the provisioning facilities on the Glencore Coal mine loops (subject to negotiation with Glencore Coal). It is unlikely that any other haulage contracts in the Hunter Valley would include a comparable offering of rolling stock for future new entrants.

- The GRail package includes established provisioning and maintenance arrangements which would not be available for a future new entrant seeking to provide haulage to other customers in the Hunter Valley.

The ACCC invites comments from market participants on the prospects of customers exercising countervailing power in their dealings with Aurizon and PN in future. This could include sponsoring the entry of new haulage providers or acquiring rolling stock.

For example:

- If you are a coal producer, what proportion of your costs of production do 'above-rail' haulage costs represent?
- In what circumstances is the threat to bypass Aurizon and PN likely to be credible?
- How large do a customer's rail tasks or volumes need to be to support efficient and sustainable entry of a haulage provider or the cost-effective acquisition of rolling stock?
- If a customer wants to threaten to sponsor new entry, who could they credibly introduce into the market?
- How much of a competitive constraint does the prospect of customers exercising countervailing power impose on Aurizon and/or PN? If you are a customer, have you ever raised this as a prospect in your negotiations with them?
- If you are a customer, have you considered sponsoring the entry of a new haulage provider or have you acquired or considered acquiring rolling stock? How do these options compare with continuing to use Aurizon and/or PN? How much would Aurizon and PN's prices need to increase before these alternatives would be a viable option?
- What effect, if any, did the establishment of X-Rail / GRail have on Aurizon's or PN's approach to the market?
- What, if anything, do any of the historical examples of entry to rail haulage markets, including the circumstances surrounding them, demonstrate or indicate about the likelihood of Hunter Valley coal producers sponsoring the entry of new haulage providers or acquiring their own rolling stock as an alternative to acquiring haulage services from Aurizon or PN?

The ACCC particularly invites detailed comments on:

- whether the GRail sale is a special opportunity for market entry, compared with, for example, bidding for a customer's contract in the ordinary course
- the specific components of the GRail assets and interests that might put an Alternative Purchaser in a stronger position to enter the market than another business.

ACCC's future steps

75. As noted above, the ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of the acquisitions. Submissions are to be received by the ACCC no later than 21 October 2016 and should be emailed to mergers@accc.gov.au.

76. The ACCC will finalise its view on this matter after it considers the submissions.

77. The ACCC intends to publicly announce its final view on the proposed acquisitions on 15 December 2016. Although the review timelines are currently aligned, they may not remain aligned. As set out in the *Informal Merger Review Process Guidelines,* the review timelines can be affected by factors such as market feedback and the need to obtain further information from either Aurizon or PN.

78. Public Competition Assessments for the purpose of explaining the ACCC's final views may be published following the ACCC's public announcement.