

- 3 JUL 2009

DATE RECEIVED



Mr John Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear John

QR Network's Draft Amending Undertaking West Blackwater Reference Tariff

As you are aware QR Network and Felix Resources jointly obtained an extension of the deadline for responding to the Queensland Competition Authority's (QCA) Draft Decision on the QR Network's Draft Amending Access Undertaking (DAAU) for the West Blackwater Reference Tariff to the 3 July 2009.

This extension allowed QR Network and Felix Resources to progress resolution of Felix Resources' concerns with the West Blackwater Reference Tariff.

Following these discussions, QR Network is proposing to modify its approach to determining the West Blackwater Reference Tariff to reflect the existence of capacity on the infrastructure in excess of that needed for the Minerva train services. QR Network therefore proposes to withdraw the West Blackwater DAAU given to the QCA in October 2008 and resubmit a revised DAAU consistent with this methodology.

Please find attached a revised submission for a DAAU of the 2008 Undertaking for the West Blackwater Reference Tariff. This submission comprises an explanatory document (including our proposal to Felix Resources and their acceptance), together with clean and marked up versions against the 2008 Undertaking.

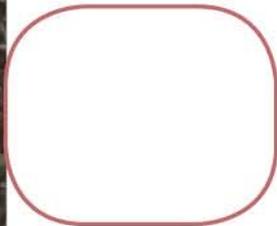
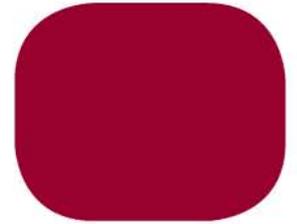
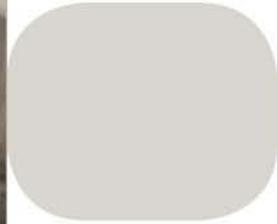
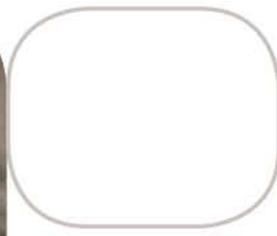
Please contact Gayle Andrews on 3235 5476 should you have any further queries regarding this submission. We have copied this cover letter to Felix Resources for information.

Yours faithfully



Mike Carter
Executive General Manager
QR Network Pty Ltd

3 July 2009



West Blackwater
Reference Tariff
*Draft Amending Access
Undertaking
Date: 03 / 07 / 2009*

1. Introduction

This submission has been prepared by QR Network in accordance with its obligations under section 6.4 of the QR Network 2008 Access Undertaking (the Undertaking) to develop a Reference Tariff for coal carrying Train Services utilising Rail Infrastructure from Burngrove to Minerva.

The submission has been prepared as a Draft Amending Access Undertaking (DAAU) to the Undertaking. Accordingly, this submission formally withdraws and replaces the West Blackwater Reference Tariff DAAU given to the Queensland Competition Authority (QCA) on 30 October 2008.

Following the release of the QCA Draft Decision (the Draft Decision) on 19 March 2009, QR Network engaged in further dialogue with Felix Resources, the primary affected party of the proposed Reference Tariff, to improve the understanding of the Customer on the requirement for the Reference Tariff and our own understanding of the commercial risks to the Customer of the proposed Reference Tariff.

As a consequence of this dialogue, QR Network is proposing a revision to the methodology used to determine the West Blackwater Reference Tariff. This submission details only the revision in the methodology and the consequential effects on the Reference Tariff and the Blackwater System Allowable Revenue (SAR). All other aspects of the Reference Tariff, other than those identified in this submission, are to be taken as consistent with the DAAU given to the QCA on 30 October 2008.

In order to expedite the QCA's consideration of the Reference Tariff, Felix Resources has provided QR Network with a letter endorsing the proposed Reference Tariff and the basis with which it has been determined. A copy of this letter is included at Attachment A of this submission.

The proposed Reference Tariff is the outcome of dialogue between Felix Resources and QR Network and represents an agreed position. Accordingly, the maintenance of this agreed position is contingent upon the approval of the proposed Reference Tariff as submitted.

1.1 October 2008 Submission

The West Blackwater Reference Tariff given to the QCA in October 2008 proposed a Reference Tariff that would equate to approximately \$5.67 per net tonne for coal carrying Train Services originating from the Minerva mine. The proposed Reference Tariff was based on:

- a building blocks methodology;
- a Depreciated Optimised Replacement Cost asset valuation; and
- forecast train operations from the Minerva mine.

1.2 QCA Draft Decision

The QCA released its Draft Decision on 19 March 2009 proposing to accept a Reference Tariff of \$5.67 as reasonable based on:

- the Reference Tariff was within the Authority's capacity related assessment of \$4.42 to \$6.97 per net tonne; and
- the uncertainty associated with future use of the line for coal carrying train services and its actual carrying capacity;
- the relativity to the higher Rolleston access charge of \$5.88 per net tonne.

However, the QCA did express some concern over the use of DORC on pre-existing assets where its application involves:

*'a mechanistic recovery of DORC valuations for infrastructure that offers a standard of service that falls quite some way short of a purpose built heavy haul coal railway.'*¹

1.3 Stakeholder Dialogue

On 24 April 2009 the QCA extended the time limit for responses to the Draft Decision to 5 June 2009 following representations by Felix Resources to the Authority. Following the extension of time frames QR Network and Felix Resources jointly applied to the QCA for a further extension of the time limit for responses to Draft Decision to 3 July 2009. This extension was sought to allow QR Network and Felix Resources to progress discussions aimed at resolving Felix Resources' concerns with the West Blackwater Reference Tariff in a way that is acceptable to QR Network, given the specific characteristics of the rail infrastructure between Burngrove and the Minerva mine.

Felix Resources principle concern relates to the application of the DORC principles to a single relatively low volume coal user of existing Rail Infrastructure, particularly given its lower service quality and its capacity to be used for alternate services. Felix Resources also has some concerns regarding the range of possible Reference Tariff outcomes in future regulatory periods through the application of the DORC principles.

In QR Network's view, while some service quality issues exist for the Nogoia to Wurba Junction line section, as evident in the longer section run times and lower maximum speed (60 km/hr), the service quality has been largely reflected in the DORC valuation. Therefore the main driver of issues is the existence of capacity on the infrastructure in excess of that needed for the Minerva train services (as evidenced by the significant number of non-coal train services).

Based on its dialogue with Felix Resources, QR Network is prepared to adjust its approach to assessing the West Blackwater Reference Tariff to reflect the extent to which the capacity of the Rail Infrastructure used for alternate purposes. In doing so, QR Network considers it reasonable and necessary from the perspective of regulatory certainty to apply an alternate approach which recognises these capacity related issues and is objective, repeatable and adaptable to changing circumstances on the relevant Rail Infrastructure over time.

¹ QCA (2009) Draft Decision – West Blackwater Reference Tariff Draft Amending Undertaking, March, p.9.

Section 2 of this submission details the methodology QR Network proposes to apply to determining the West Blackwater Reference Tariff for the 2008 Undertaking. QR Network proposes that this methodology will also form the basis for determining the West Blackwater Reference Tariff for future regulatory periods.

2. West Blackwater Reference Tariff

2.1 Rationale

A key driver of the proposed Reference Tariff in the DAAU of October 2008 is the return on and the return of capital based on the opening DORC valuation. QR Network considers that the determination of a Reference Tariff that is lower than the ceiling price should be given effect through the modification of its approach for the recovery of that opening DORC valuation.

QR Network proposes to base the West Blackwater Reference Tariff on an allocation of the opening DORC valuation for the Burngrove to Wurba section (i.e. the value prior to any investment required specifically for the commencement of coal services) between coal and non-coal users. QR Network proposes to determine this asset allocation based on the relativity of the expected utilisation of train paths by coal and non coal Train Services over the Burngrove to Nogoia line section.

Prior to the commencement of coal carrying Train Services from the Minerva mine, the Burngrove to Nogoia line section was used solely for general freight, grain and passenger services. With the exception of passenger services, general freight, grain and livestock services operate on an opportunity basis in the daily train plan (i.e. are not contracted paths). As a result, the expected utilisation by non-coal train services used for determining the allocation has been based on actual train operations for the 2007-08 year, as this year represents the first year in which coal carrying train services for the Minerva mine operated close to contracted levels and provides the best representation of the train path availability to non-coal services in a capacity constrained Blackwater System. The expected utilisation of train paths by coal Train Services is based on the Access Agreement for the Minerva mine.

On this basis, QR Network proposes to establish the Initial Allocation based on a **53.4%** coal utilisation rate (the Allocation Rate).

In order to provide certainty to all stakeholders, QR Network does not intend to vary the Allocation Rate to reflect annual variability in the utilisation of the network by non-coal users. However, QR Network does propose that this allocation be reviewed where additional train paths are contracted by coal Customers. This allows QR Network to improve its commercial performance from additional coal services through increasing its level of recovery of the initial DORC valuation, thus providing a strong volume incentive. However, this approach also provides for any increase in volume through better utilisation of the existing paths by above-rail operators to reduce the equivalent \$/net tonne access charge.

2.2 Initial Allocation

QR Network proposes to include the \$75.4 million DORC as at 1 July 2007 in the Central Queensland Coal Region Regulatory Asset Base (RAB) as per the October 2008 DAAU. The \$75.4 million is representative of the valuation of existing Rail Infrastructure prior to the commissioning of the Minerva Project and the Minerva project costs and subsequent capital expenditure.

However, for the purposing of establishing Reference Tariffs for Coal Carrying Train Services, the tariff modelling will be based on an Allocated RAB which will be comprised of:

- an allocation of the value of the Rail Infrastructure existing prior to the commissioning of the Minerva project based on the Allocation Rate:
- the Minerva project costs; and
- all future coal related capital expenditure

As the Allocated RAB is established with reference to total service levels and the DORC is based on an optimised coal only corridor, QR Network considers it reasonable to add optimised assets to the DORC to reflect the assets currently providing all Train Services prior to determining the Allocated RAB. QR Network has identified an additional \$1.5 million in depreciated asset values associated with passing loops and signalling that it has added to the DORC value prior to allocation. QR Network has included a summary of the valuation of these assets at Attachment B.

For the purpose of determining the Reference Tariff for Coal Carrying Train Services in the proposed West Blackwater Cluster the asset values in Table 1 represent the Allocated RAB as at November 2005.

Table 1. Initial Asset Allocation (as of November 2005)

Line Section	Capital Value (million)
Burngrove to Nogoia	\$20.3
Nogoia to Wurba Junction	\$8.7
Minerva Project Costs	\$18.4
Total Allocated RAB	\$47.4

The rolled forward Allocated RAB at 1 July 2007 for coal pricing purposes is detailed in Table 2.

Table 2. Allocated RAB Roll-Forward for Coal Pricing

(\$000s)	2005-06	2006-07
Opening asset value	29,002	47,060
capital expenditure	18,374	4,863
inflationary gain	786	1,237
depreciation	1,102	1,777
Closing asset value	47,060	51,382

2.3 Reasonableness

The Initial Allocation (excluding the Minerva capital expenditure) is equivalent to the approximately 15% of the optimised replacement cost (ORC) for the Nogoia to Wurba line section and 25% of the ORC for the Burngrove to Nogoia line section. This is a considerable discount to the DORC value and is comparable to the DORC valuation and usage levels proposed by the Australian Rail Track Corporation's valuation of the GAP to Dartbrook line in the Hunter Valley as shown in Table 3.

Table 3. Comparison to Hunter Valley Coal Network

	% of ORC	Million Gross Tonnes
Burngrove to Wurba	15% and 25%	4.3
The Gap to Dartbrook ²	52%	6.5

The resultant Reference Tariff in Section 2.4 is also within the QCA's reasonable range of \$4.42 to \$6.97 per tonne.

2.4 Reference Tariff

The proposed West Blackwater Reference Tariff based on the October 2008 DAAU building block assumptions and the Allocated RAB that would apply from 1 July 2007 would be as follows:

Reference Tariff Component	Reference Tariff (\$2007-08)
AT ₁	0.71
AT ₂	1470.72
AT ₃	4.00
AT ₄	1.68
QCA Levy	0.0056

As this proposed Reference Tariff is equivalent to \$4.60 per net tonne it exceeds the nearest existing Reference Tariff equivalent to \$3.27 per tonne. Accordingly the West Blackwater Cluster remains a requirement under the 2008 Undertaking.

The AT₂ rate is lower than that proposed in the October 2008 DAAU. The difference is attributable to the exclusion of the capacity multiplier. While the balance of the Reference Tariffs have been determined with regard to forecast revenue from the AT₂ charge inclusive of the multiplier, the inclusion of the multiplier in the AT₂ specified within the Reference Tariff is not required, as the Access Agreement provides for the multiplier to be applied to train services exceeding the standard section run times (which are based on electric services).

Consequential amendments to the 2008 Undertaking, including revised Blackwater System Allowable Revenues, is detailed in the marked-up and clean versions of the amended 2008 Access Undertaking at Attachments C and D respectively.

² Booz&co (2008) Final Report, ARTC Standard Gauge Rail Network DORC – GAP to Dartbrook Line, June

3. Attachment A – Customer Acceptance

4. Attachment B – Optimised Asset Valuation

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5. Attachment C – 2008 Undertaking (marked-up)

6. Attachment D – 2008 Undertaking (clean)