



19 August 2011

Private and Confidential

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

By Email: To: rail@gca.org.au

Dear John,

QR Network's Rail Connection Agreement (Coal)

I refer to the Queensland Competition Authority's ("QCA") invitation to provide submissions regarding QR Network's proposed Rail Connection Agreement.

Vale Australia Pty Ltd ("Vale") has significant expansion plans for its coal mining activities in Queensland and thus has a strong interest in ensuring that all agreements developed by QR Network provide an efficient and effective process by which users access the Queensland coal rail network. Vale welcomes the opportunity to respond to the QCA regarding this proposed agreement.

Context for this submission

Vale provides this submission in the context of the Rail Connection Agreement being a key element in the process by which miners acquire the logistics capacity to ship coal to port.

This submission provides commentary on the key specific risks Vale sees with the proposed Rail Connection Agreement. It also notes that the Rail Connection Agreement is one of a suite of agreements being developed by QR Network that provides the framework to the planning, construction, funding and access to below rail infrastructure.

Vale is planning to substantially expand its coal production in the Bowen Basin and will therefore require additional capacity across the Queensland coal rail network. Vale is therefore focused upon ensuring that the process to achieve an enhancement or extension to the network is efficient and one which delivers the required capacity outcome on reasonable terms.

Our understanding of the QCA's role

Vale understands that the QCA's responsibilities in relation to the Rail industry are to:

- Assess and approve third-party access undertakings to Queensland's intrastate rail network;
- Arbitrate access disputes;
- Enforce breaches of access obligations; and
- Assess competitive neutrality

In this context Vale understands that the QCA's role with respect to the Rail Connection Agreement is ensuring that the substance of this agreement is consistent with the requirements placed on QR Network by the QCA under Clause 8.4(a) of the 2010 Access Undertaking and with the principles QR Network has sought to apply in developing the Rail Connection Agreement.

Our understanding of QR Network's principles in developing this agreement

In its publication QR Network's explanatory notes to proposed Standard Rail Connection Agreement (Jul 11), QR Network set out the principles it has sought to apply in developing the agreement. These principles are:

- "Providing a safe connection, built and upgrades over time, to a suitable standard (now and ongoing);
- Seeking reimbursement for the provision of connection services so that there is no incremental cost to QR Network for the connection, now or in the future; and
- Ensuring trains are loaded to appropriately manage risk on our network."

Vale provides comments as to whether it considers the proposed agreement is consistent or otherwise with these principles.

Comments on the Rail Connection Agreement

As an initial general comment Vale is of the view that connecting a rail spur should be a relatively simple process. Miners have a strong incentive to construct and maintain the rail spur infrastructure as a mechanism to ensure contracted coal output can be efficiently delivered. As a result, Vale believes the appropriate framework that should underpin the Rail Connection Agreement is one that focuses on the development of output specifications for the spur line design and operations and the QR Network connection infrastructure. This allows users to develop spur rail assets with cost and timing certainty.

In respect of the Rail Connection Agreement Vale makes the following specific comments:

Clause 20 – Vale believes that there is some inconsistency between QR Network agreements with respect to the amount and type of security required. Vale's view is that the total security package to apply over the full suite of agreements a user will need to execute with QR Network to gain rail capacity should be negotiated as a whole, reflecting the net exposure and credit position of the user. Vale believes that the net security position should be set during negotiation of the expansion deed. The explicit requirement for a bank guarantee in the Rail Connection Agreement is not acceptable to Vale, particularly in the context of security requirements under the other agreements.

Clause 6 – This clause creates the liability for a user to pay for construction and maintenance of the infrastructure built to connect the User spur line to the main network. Vale is of the view that the powers of QR Network to require enhancements to the connecting infrastructure are overly broad with significant risk of over specification, reducing flexibility, adding cost and potentially degrading network performance. Vale believes that appropriate standards and configurations of connection infrastructure should be defined, with users then able to effectively control the implementation of the connection process with QR Network's role limited to certifier and operator. Vale would highlight that the first key QR Network principle, "suitable standard", should be able to be objectively determined and not rely on QR Network's sole judgement.

Clause 7 – This clause provides QR Network with the ability to require a user to improve the spur line infrastructure. As with Clause 6 Vale believes that this clause is too broad; the standards required for rail infrastructure should be well defined with a transparent, independent approval process in place that gives users certainty over the cost and operational protocols that accompany the connection and operation of coal logistics infrastructure. Furthermore, it implies that infrastructure that is compliant with design standards or QR defined standards may still be deficient and require additional investment. With no reference to defined standards this is potentially an open ended clause from the perspective of users and raises similar concerns to Clause 6 with respect to the stated QR Network principles.

Schedule 7 – This schedule makes the QR Network coal loss mitigation procedures compulsory for a user executing the Rail Connection Agreement and allocates liability for *all* coal loss incidents to the user. Firstly Vale does not believe these restrictions belong in the Rail Connection Agreement. The loading of coal trains such that the chance of fugitive and parasitic coal is minimised is generally under the control of the haulage contractor and as a result the Schedule 7 or its equivalent belongs in the above rail agreements negotiated between users and haulage companies.

Secondly Vale believes that this schedule is an example of inappropriate matching of input specification and liability. The standard commercial approach in respect of operational type provisions is either:

- Specify the outcomes that the operational protocols are required to achieve, leaving users to put in place their own methods to meet these requirements. Users in this case are fully liable where they fail to achieve the output requirements.
- Specify in detail the protocols users must put in place but in this case the entity responsible for the protocols (QR Network in the Rail Connection Agreement) takes responsibility that the protocols can deliver the outcomes required.

Vale's view is that in general the coal industry participants, both miners and haulage contractors, are experienced in the management of coal loss issues and thus the first approach represents the optimal position. The second option reduces the flexibility of miners to manage coal transportation issues and potentially exposes them to additional cost without any necessary improvement in the performance of coal transportation with respect to coal loss experience.

Force Majeure Event – it is Vale's view that the definition of force majeure event as drafted is broad and captures events that Vale deems are not typically considered to be force majeure events. For example, subclause (g) referring to "Good Engineering Practices" as being the determinant as to whether equipment failure and breakdown is to be considered a force majeure event is a nebulous concept and is likely to result in dispute between parties. Furthermore, equipment failure and breakdown risks are typically managed within contingencies and QR Network is adequately compensated by this in the charges paid under the agreement.

Concluding remarks

Vale's key concern with the proposed agreement is that QR Network retains too much latitude to control development of core user infrastructure. We note the similarity of these issues to those contained in our letter of 11 August 2011 commenting on the proposed End User Access Agreement that is the continuing subtle shift of risk away from that intended under the Access Undertaking.

Vale believes that the operational importance of efficient and safe spur line and connection rail infrastructure is well understood by all miners. The approach defined in the proposed Rail Connection Agreement does not recognise this experience, effectively establishing QR Network as the sole judge of what is appropriate rail infrastructure. Vale is of the strong view that given the process by which prospective users need to navigate to acquire capacity on the QR controlled network, there is no justification for a connection agreement that places further potential barriers in commencing production. The appropriate approach is therefore to agree spur and connection design and operational standards and allow users a rapid connection process where they can provide independent certification of their infrastructure and operational protocols. To do otherwise reduces the efficiency with which miners can plan and execute substantial development projects

Vale would further note that the connection of user spur lines will generally be the last process to be negotiated with QR Network prior to a user commencing train operations and as a result there will likely be time pressure on individual users to conclude these negotiations quickly. This creates additional asymmetry in negotiation power, potentially leading to a further erosion of the risk balance between miners and QR Network. Vale is aware of general industry concerns over this from recent unregulated transactions.

Vale provides this submission on a confidential basis and advises that content provided within this submission is of a commercially sensitive nature and we request the QCA to ensure this information provided remains confidential except for the intended use of this submission

Vale would welcome the opportunity to discuss these comments with the QCA in greater detail.

Yours sincerely,



Bob Skuza
General Manager Logistics
Vale Australia Pty Ltd