



11 August 2011

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

Dear Sir

QR Network's End User Access Agreement (Coal)

I refer to the Queensland Competition Authority's ("QCA") invitation to provide submissions regarding QR Network's proposed End User Access Agreement (Coal).

Vale Australia Pty Ltd ("Vale") has been an active participant in industry discussions and takes an active interest in ensuring that the agreements developed by QR Network provide access terms and conditions which comply with the requirements of the QCA Act 1997 and, most importantly, provide commercial and practical solutions to all industry participants. 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 End User Access Agreement being developed to improve the long term certainty of access rights to users through an Alternate Form of Access where End Users could directly contract with QR Network for Access Rights without assuming obligations for performance by a Train Operator as would be required under the Standard Access (Holder) Agreement.

This submission provides commentary on the key specific risks Vale sees with the proposed End User Access Agreement. It also notes that the End User Access 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. This raises several issues for the QCA to consider in the context of how this agreement interrelates with the proposed User Funding framework and access undertaking. Vale will respond separately to the QCA in regard to consultation on each of these other agreements.

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 End User Access Agreement is ensuring that the substance of this agreement is consistent with the requirements placed on QR Network

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by the QCA under Clause 5.2(n) of the 2010 Access Undertaking and with the principles QR Network has sought to apply in developing the End User Access Agreement.

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

In its publication Explanatory Notes for Proposed Standard Access Agreements and Consequential Amendments to the 2010 Access Undertaking dated 18 May 2011, QR Network set out the principles it has sought to apply in developing the End User Access Agreement. These principles are:

- "the agreements should allocate functions and responsibility to the most appropriate party
- the agreements should not result in conflict between the administration of a Standard Access (Operator) Agreement and the Alternate Form of Access
- a customer who wishes to hold a Standard Access (Operator) Agreement should not be disadvantaged relative to one who holds the Alternate Form of Access
- there should be parity of agreements within the operating and scheduling processes
- the current Standard Access (Operator) Agreement should still be available to Access Seekers
- the agreements should not seek to change the risk level or risk profile assumed in the scope and nature of the access undertaking as required in Clause 5.2(n)(iii)."

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

Comments on the End User Access Agreement

In respect of the End User Access Agreement Vale makes the following specific comments:

Clause 2.3 – The process regarding the selection and nomination of train operators seems unnecessarily restrictive. A user access holder is required to give 30-days notice and must nominate for periods of not less than 3 months when managing its above rail operations. QR Network has sought to justify this through indicating that it will need to manage its commercial risks in relation to path nomination from a capacity and scheduling perspective¹. From a user perspective, such conditions prevent users from effective management of haulage requirements forcing them to lock into longer term contracts; which naturally favours existing above rail contractors. This limits users' ability to utilise ad-hoc paths with other operators. This is likely to unduly limit the flexibility of access holders to utilise capacity, the net result of which will likely be the less efficient use of that capacity.

Clause 3.4 (a) – Vale rejects the need for a minimum of twelve weeks of access charges being provided as security to QR Network. Vale would note that the existing minimum security level under the access undertaking is six weeks and, further note that there is a lack of clarity over the security levels required within extension deeds negotiated outside the access undertaking. This implies the setting of any minimum security level may represent an unwarranted risk re-allocation to users taking part in an expansion process. Vale believes that an appropriate level of security cannot be set without reference to the charges and credit risks associated with the suite of agreements developed in relation to a material enhancement project.

Clause 4.1 – Under this clause QR Network reserves the right to resume capacity from a user where the user has failed to utilise 85% of its allocated train services over 4 consecutive quarters. Vale understands the need to prevent inappropriate capacity hoarding, but believes that the QR Network rights are overly broad given:

- The actual coal system capacity is not well defined for any of the QR Network coal systems and thus determining whether a user has failed to use train services due to its inaction or system capacity issues is problematic
- The lack of flexibility in this agreement around short term capacity transfers and haulage contracting limit the ability of users to efficiently manage temporary excess capacity

Vale is of the view that anti-hoarding provisions can only be effective where capacity trading is efficient and system throughput is appropriately measured. Vale considers this to be an inappropriate balance between the ability to efficiently utilise capacity versus the hoarding of capacity.

Clause 4.2 – The structure of this clause unnecessarily complicates the process by which access holders can transfer or trade short term capacity. We are aware of other Australian coal supply chains that permit

¹ Alternate Form of Access for Coal Carrying Train Services, QR Network, 18 May 2011

ad-hoc capacity transfers with as little as 2 to 3 days notice such as that in the Hunter Valley. Provided that transferees have available haulage capacity with accredited operators we see no reason for QR Network to play a material role in user management of short term capacity trading. This is likely to unduly limit the flexibility of access holders trading short term capacity, the net result of which will be the less efficient use of that capacity.

Clause 4.5 - This provides QR Network with the ability to simply wind back capacity from access seekers where an enhancement does not provide the expected increase in capacity. This provision, when combined with QR Network proposed extra-regulatory expansion agreements, implies that QR Network will accept no material risk over:

- The suitability of the design of a project to meet the capacity requirements
- The construction time and cost profile of the expansion projects
- The actual/installed capacity the enhancements deliver
- The extent to which expansions are included in the RAB

QR Network is therefore seeking a return significantly above the appropriate return determined by the QCA and a risk exposure significantly more favourable than that assumed by the QCA in setting the regulated return. Vale's view is that QR Network's liability with respect to enhancement capacity cannot be set without reference to the risk it has borne over the entire project process.

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 understands that while many of the terms of the End User Access Agreement have evolved over time and reflect the conventional thinking in the industry towards access, they have largely been developed under the assumption that QR Network's responses to proposals for capacity expansion would be subject to the regulatory process. Recent industry experience suggests that QR Network will only invest in substantial capacity expansion where it can secure a return above the regulatory return together with a risk allocation that is more favourable than that available under the regulatory framework. As a result Vale believes that the overall risk allocation implied in the End User Access Agreement may need to be reviewed so as to balance QR Network's approach in negotiating enhancements outside the regulatory framework. This is, in Vale's view, inconsistent with the principles set out above which state that the agreements should not seek to change the risk level or risk profile assumed. In practice, the proposed End User Access Agreement shifts the risk profile in subtle but important ways. This is likely to have the effect of exposing access holders to increased risk, whilst reducing the flexibility in utilising access rights. This would appear to be inconsistent with the intent of the access regime.

Vale's key concerns are to ensure that the end-to-end process, from the execution of the study funding agreement to the approval to connect Vale-owned spur lines to the QR Network supply chain is as efficient as possible and reflects a commercially viable and bankable risk position. Specifically, Vale is seeking to ensure:

- Sufficient flexibility so that it can optimise its haulage contracts and scheduling across the coal systems
- Continuing incentive for QR Network to provide the expected rail capacity with appropriate risk allocated to QR Network over actual capacity provided by QR Network controlled material enhancements
- No unreasonable barriers exist that impede its ability to trade or transfer logistics capacity

Vale considers that the lack of a definite picture of the risk structure QR Network requires in undertaking further material capacity enhancement creates significant uncertainty over the appropriateness of key agreement provisions. The basic negotiation position as understood by Vale is that the core access agreements will be the last documents to be considered as part of a larger capacity enhancement transaction. This is because it is expected that the QCA-approved terms will be generally acceptable to both parties. The potential for QR Network to reset key risk allocation provisions through early negotiation of the enhancement deeds means that this is no longer a sound assumption.

Vale believes that the overall implication for the End User Access Agreement is that its commercial structure needs to be integrated within the QR Network expansion process to ensure users are protected from QR Network's monopoly power in negotiations that are typically more time-critical to access holders than they are to QR Network. This implies a need to re-consider core terms developed under the assumption of a regulated expansion framework, given that a regulated expansion framework is no longer the typical approach adopted by QR Network. Vale believes that the QCA has a role to play here in ensuring that the risk profile remains consistent with the Access Undertaking.

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

Yours sincerely,



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