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Dear Professor Menezes,

QUEENSLAND RAIL'S 2020 DRAFT ACCESS UNDERTAKING

Incitec Pivot Limited (**IPL**) welcomes the opportunity to provide a submission to the Queensland Competition Authority's (**QCA**) Draft Decision on Queensland Rail's (**QR**) 2020 Draft Access Undertaking (**DAU2**) (**Draft Decision**).

- 1 IPL is an Australian-based global manufacturing company producing a wide range of commercial explosives, industrial chemicals and fertilisers.
- 2 IPL owns and operates manufacturing plants in the US, Canada, Australia, Mexico, Indonesia and Turkey. IPL has joint venture operations in the USA, Canada, Mexico, South Africa, Malaysia and Australia.
- 3 Among other manufacturing facilities in Queensland, IPL owns and operates two world-scale facilities in north west Queensland:
 - (1) an open-cut phosphate rock mine and a fertiliser manufacturing facility at Phosphate Hill, Queensland, which is the biggest fertiliser plant in Australia. It has an annual capacity in excess of 950,000 tonnes; and includes export and warehouse facilities; and
 - (2) a sulphuric acid plant at Mt Isa, Queensland. Sulphuric acid is an essential ingredient in the manufacture of ammonium phosphate fertilisers produced at the Phosphate Hill plant.

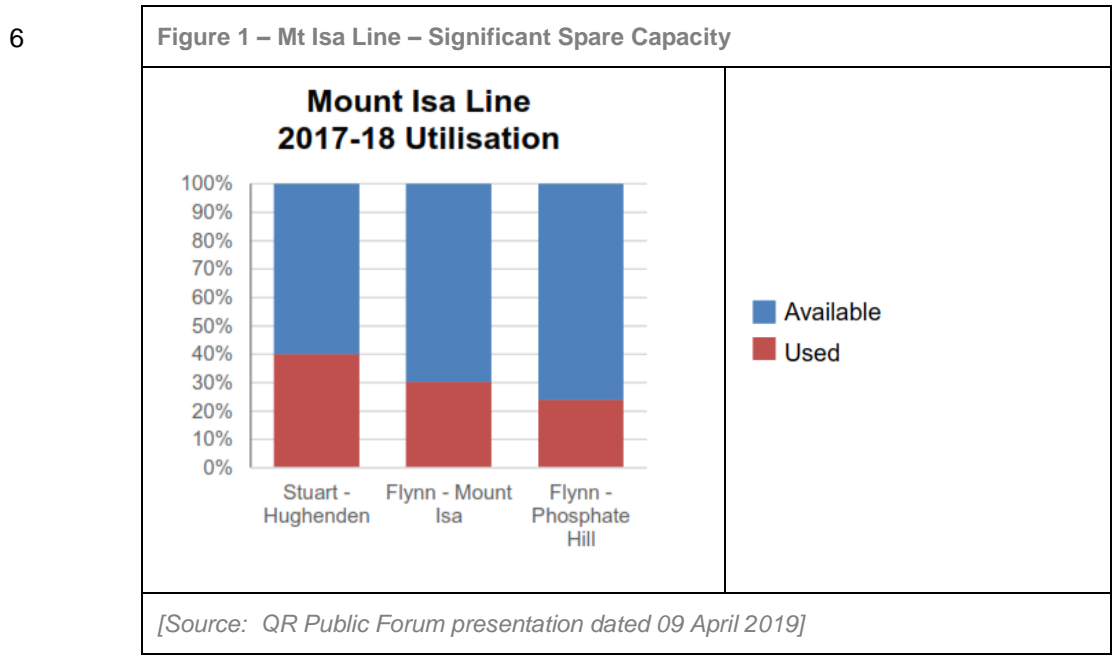
Together, these operations employ over 700 people and are almost wholly reliant upon QR's Mt Isa Line for the inbound shipment of sulphuric acid and outbound shipment of fertilisers for both Australian farmers in the grains, cotton, horticulture, sugar and dairy industries, as well as for export.

In addition, IPL owns and operates an ammonium nitrate manufacturing facility (~360,000 tonnes pa production capacity) at Moranbah to service mining in the Bowen Basin footprint in Queensland, and a fertilisers production facility at Gibson Island, Brisbane, for manufacture of ammonia, urea, ammonium sulphate, and other industrial chemicals products.

- 4 IPL has made, and continues to make, substantial financial investments into its operations at Phosphate Hill and Mt Isa. The plants have an ongoing need for further investments (approximately \$100M) at four (4) year intervals to perform major maintenance, equipment overhauls, and regulatory inspection activities. Rail haulage, rail access, natural gas and mining services represent key input costs for Phosphate Hill. Given the level of investment required to be made at the plants, IPL requires the security of long-term contracts for these inputs, among other things, in order to justify the investment risk. This is necessary to ensure sustainable long-term operations at the plant, to provide reasonable opportunity for pay back on the four-yearly maintenance investments, and to maintain the hundreds of direct, skilled

jobs that are vital to the regional economy, as well as the infrastructure set-up to maintain the remote workforce, and the downstream jobs provided as a consequence of the facility.

- 5 It is IPL’s understanding that the Mt Isa Line has a current utilised capacity of less than 40% (see Figure 1 below). Given that fact, the commercial and regulatory framework associated with operation and usage should be designed to encourage users to make long term commitments to Access Rights and seek to incentivise further investment that will benefit line utilisation.



- 7 IPL welcomes certain aspects of the Draft Decision, but also asserts that some shortcomings within the current Access Undertaking (**AU1**) have not been adequately addressed by QR or the QCA.

As set forth more fully below, these issues include:

1. Pricing;
2. Take or pay Charges;
3. Barriers to Long-Term Access Rights, and
4. Ongoing Optimisation of Train Services

Pricing

- 8 Access Rights for the Mt Isa Line are not competitive relative to other rail operations in the QR network or with those in other Australian states.

Aurizon’s Bulk Submission on QR 2020 DAU, 1.1 identifies that, unlike every other QR line, the Mt Isa Line does not benefit from Transport Services Contract revenue from the Queensland Government. Accordingly, user pricing is significantly more expensive than other lines, leading to an uncompetitive position for the transportation of manufactured products. Specifically, the Mt Isa Line customers pay between \$14.00 and \$15.30 per ('000) GTK compared to North Coast Line customers, paying between \$5.00 and \$5.40 per ('000) GTK (including Aurizon Network Charges). This massive differential presents a significant challenge for companies operating in north-west Queensland, where raw material and labour costs are high, and especially when trying to compete in global commodity markets which are highly trade exposed.

Similarly, the Mt Isa Line is more expensive when compared to other Australian states. For example, New South Wales rail users typically pay between \$2.58 and \$7.65 per ('000) GTK.

The clear economic outcome of this disparity is to make other states more attractive for new investments that require rail services and hinder the ability of users already invested in Queensland to remain competitive. For commodity producers, logistics and transport is always a substantial expense, and investment decisions are inevitably made after thorough consideration of transport cost and risk.

Given the high access charges for the Mt Isa Line, IPL submits that it is critical that the pricing framework under the DAU2 appropriately balances the legitimate interests of QR and Access Holders, but also the objectives of the Queensland Government in sustaining regional employment, encouraging and attracting sustenance and growth investment, and fairly considers a truly competitive position, particularly in North Queensland.

9 The proposed changes to DAU2 do not effectively achieve the required balance to achieve key objectives. In particular, two key pricing features in DAU2 require further amendment:

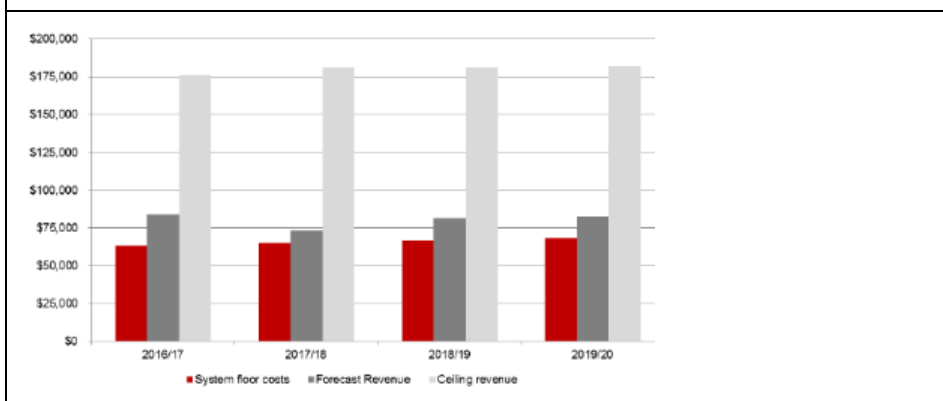
(1) QR, as a monopolist provider, retains discretion to price within a very wide range that does not adequately reflect the needs of users and leaves little room to negotiate in good faith to reach a commercially viable outcome. While in principle it is reasonable to establish floor and ceiling revenue limits, the current range is too wide to be meaningful, leaves ultimate discretion to QR, and leads to an uncompetitive position compared to other rail lines in the QR network.

By its own figures (see Figure 2 below), QR is entitled to earn up to \$175 million in access charges for the Mt Isa Line. This represents 230% more than the \$75 million revenue it earned in FY2018 from that Line and which included profit of \$16.2 million. Without any changes to the volume of rail traffic on the Mt Isa Line, such a high ceiling permits QR to price at levels which are unsustainable for IPL and other users, and will ultimately lead to loss of investment, loss of jobs, plant closures, and therefore significantly decreased rail traffic on the Line, as well as major damage to the local economy.

(2) There is no transparency regarding the floor price calculation because no formula is included in DAU2 by QR. IPL concurs with Aurizon Bulk's submission that the formula should be disclosed (Aurizon Bulk Submission on QR 2020 DAU Draft Decision, 3). Without knowledge as to how the floor price is determined, users cannot understand the justifications behind how the pricing band is established. This in turn makes it impossible for QR and users to negotiate an appropriate outcome that adequately considers the needs of all parties. More importantly, in a monopolistic scenario, it leaves open power inequity that leads to uneconomic outcomes.

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Figure 2 - QR Mt Isa Line Estimated Floor and Ceiling Revenue Capacity Based on Forecast Volumes



11 The current proposed pricing principles give QR discretion to price Access Rights at levels which are unsustainably high. As stated, this will ultimately destroy demand by making it uneconomic for parties to continue to invest and assume business risk and expect a reasonable return.

As it stands, there is little certainty for users on future pricing parameters, and little ability to ensure negotiation of a fair and competitive commercial arrangement with QR. As a large employer in north-west Queensland and a major user on the Mt Isa to Townsville rail line, IPL is significantly hindered in its ability to secure the inputs it needs to sustainably operate its business, make investment decisions, and ensure ongoing regional employment.

12 As justification for the proposed model, QR's submitted expert opinions draw conclusions about Access Holders which operate in markets that are very different to IPL's. QR has asserted that:

- (1) road transport is a feasible option (HoustonKemp Independent Expert Report for Queensland Rail on DAU2 Renewal rights dated 19 July 2018, 8); and
- (2) Rail Access Rights are a very low proportion of the end market prices received for the products and therefore do not influence ongoing viability of Access Holders' operations.

IPL does not opine regarding the veracity of these conclusions as to other users, however, represents that neither of these conclusions is viable or accurate in connection with its business.

For IPL:

- The significant additional costs and substantial worsening of the safety and risk profile, even presuming such a supply chain could be established on an ongoing basis (which is far from certain), associated with transporting fertiliser by road networks makes road transport an untenable option. Moreover, the significant social and economic impacts and burdens on the regional communities would be considerable; and
- Uncompetitive rail pricing directly impacts the cost base of all users, including IPL. However, in IPL's case, where it is required to produce on a cost base where raw materials (particularly natural gas and sulfuric acid) and associated labour rates are already high relative to its global competitors, increases in transportation costs exacerbate an already challenging cost profile.

13 As the largest user of the Mt Isa Line, IPL considers that any regulatory framework, including the price differentiation rules, must consider specific requirements relevant to users of the Line. In this instance, a failure to consider the manufacturer's requirements, as a customer, and a failure to focus on what makes a rail line competitive and efficient compared with similar QR and interstate lines, significantly reduces IPL's ability to negotiate long-term, competitive rail access arrangements with QR and could lead to an adverse investment decision that destroys demand for the Mt Isa line.

14 It is within the commercial interests of IPL, QR, and the broader communities of western Queensland to ensure that the Mt Isa Line is a viable and economic rail transport option, and to encourage modal shift from road to rail. IPL supports the position of Pacific National that encouraging usage of rail carries significant public benefit such as increased safety, reduced accident costs, and lower congestion and emissions (Pacific National submission on QR 2020 DAU Draft Decision, 5).

Take-or-Pay Charges

15 To the extent there is fair room to negotiate, IPL agrees with the QCA position that the price structure and requirement for take-or-pay charges are matters best negotiated between QR and the Access Seeker (QCA QR 2020 DAU Draft Decision, 122).

IPL concurs with submissions by Aurizon Bulk and Pacific National (Aurizon Bulk Submission on QR 2020 DAU, 2.3; Pacific National Submission on QR 2020 DAU, 5) that the current take-or-pay arrangements are inefficient, unnecessary, and not aligned to the specific customers' requirements.

The low utilisation of the Mt Isa Line means that the usual driver for take-or-pay arrangements in relation to use of monopoly infrastructure is absent. Accordingly, a take-or-pay obligation,

particularly under circumstances where IPL is inherently incentivized to produce and ship as much product on the Line as it possibly can, serves as a punitive and unnecessary measure that penalises users only in circumstances where they are already suffering adverse conditions. For example, this past year the Mt. Isa Line was closed for over three months due to major flooding that destroyed certain parts of the line. As a consequence, IPL was forced to close its plant entirely for the period of the outage due to lack of raw materials to produce and no ability to ship finished products. The impact to IPL of the closure was approximately \$115m for that period alone. Once the Line was available, IPL's plant had issues restarting as a consequence of the unplanned outage. Even with the considerable detriment to IPL's financial position as a consequence of the outage, IPL remained liable to QR for take-or-pay charges on the Mt Isa Line. This is an outcome that would never arise in a commercially negotiated scenario where monopolistic power did not exist.

IPL is open to considering modified take-or-pay arrangements that require firm commitments to the extent new traffic is introduced to the line that causes, or could cause, a shortage of available utilisation.

Further Barriers to Long Term Investment in Access Rights

16 Relinquishment Fees

QR proposed to adopt the same provisions for relinquishment fees as the current Standard Access Agreement (**SAA**) and require Access Holders to pay a fee to QR if they relinquish all or part of their access rights (clause 21.2(c) of the draft SAA).

The current SAA approach requiring a relinquishment fee based on 80% of the NPV of the path charges for the remaining contract term, is unduly punitive, and does not provide an effective way for Access Holders to relinquish unrequired paths. This causes unnecessarily high costs to release paths that are no longer required and does not encourage the most efficient use of the network.

The QCA did not consider it appropriate to approve QR's proposal in relation to relinquishment fees because it did not consider that relinquishment fee arrangements should be prescribed for non-reference-tariff services. IPL supports the QCA's position that, in the absence of a reference tariff, the commercial negotiation of an agreement between QR and the Access Seeker is the appropriate stage to consider the best package of risks, costs and entitlements. If commercial negotiations fail, either party may seek an arbitrated resolution under the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**) or the undertaking.

17 Renewal Rights

QR proposes that eligible Access Holders have certain access and pricing rights when renewing their access agreements. However, it proposes to apply more restrictive eligibility criteria for those renewal rights than those provided in the AU1, including that:

- (i) a renewal right will only be available to coal or other bulk mineral carrying train services;
- (ii) the Access Holder can only renew its access rights once (although the drafting is unclear as to whether the one-off right applies specifically to renewals for the remaining life of the mine or whether it applies to all renewals); and
- (iii) the Access Holder's existing access agreement must have between a five (5) and ten (10) year term and a maximum renewal term of five (5) years can be sought.

The QCA considered that QR's proposal to limit access to the renewal mechanism to Access Holders with contract terms of between five (5) and ten (10) years would exclude some Access Holders that have made substantial investments from accessing the mechanism. The QCA further considered that, even if an Access Holder could access the mechanism, QR's proposed

maximum renewal term of five (5) years may not be sufficient to align with the term of the Access Holder's investment.

IPL supports these observations and the QCA's recommendation that QR amend its proposed renewal mechanism so that Access Holders that have made substantial investments can obtain reasonable price and access security for the remaining life of their investments. In addition, as stated above, retaining jobs and sustaining further investment in the region should be predominate drivers in such policy arrangements.

IPL transports products (including fertiliser and sulphuric acid) pursuant to considerable investments, and its operations are required to be serviced by the Mt Isa Line. IPL submits that it, and other Access Seekers or Access Holders in its position, should have the same rights as those Access Holders that do meet the definition of 'bulk mineral'. This could be achieved by replacing the "bulk mineral" term with a new defined term representing "industrial products." Similar concerns have been expressed by other stakeholders (Aurizon Bulk Submission on QR 2020 DAU, 2.4; Pacific National Submission on QR 2020 DAU, 5).

Furthermore, one of the key rationales expressed by QR in support of its proposal to narrow renewal rights is to remove allocative inefficiency (and reduce subsidies) by allowing QR to allocate capacity to Access Seekers who value the access more (HoustonKemp Independent Expert Report for Queensland Rail on DAU2 Renewal rights dated 19 July 2018). This position clearly does not align with, nor is it applicable to, the Mt Isa Line, which is grossly under-utilised and is not the recipient of any Government subsidies. IPL submits that a one size fits all approach which considers only QR's interests on other lines is not appropriate and should not be preferred over provision of reasonable price and access security for users that have made, and continue to make, substantial investment in facilities that rely wholly or predominately on the Mt Isa Line, whilst creating significant employment opportunities within the region.

- 18 IPL welcomes the position taken by both QR and the QCA that these matters are best negotiated between QR and the Access Seeker rather than the subject of an imposed one size fits all regime.
- 19 Without certainty as to long-term Access Rights, Access Seekers will not be able to justify continued large-scale investment in an environment where there are competing areas for investment. As such, it is within the commercial interests of all parties, including the communities of North and Western Queensland to work cooperatively to ensure that the Mt Isa Line has long-term Access Rights which are aligned to realistic market conditions.
- 20 IPL submits that a User's renewal rights should also not be impacted by any change of mode of contracting with QR. For example, if there is a change from the Operator holding the Access Rights to the User holding their own Access Rights, the user should not be prejudiced in its cost positions as a consequence of that change.

Ongoing Optimisation of Train Services / Ad Hoc versus Additional Train Services

- 21 QR's position is that allowing additional services, but not ad hoc services, to offset an access holder's take-or-pay liability is appropriate.
- 22 The QCA has adopted QR's position and does not consider it appropriate to use revenue from different types of services (i.e., ad hoc services) to reduce an Access Holder's take-or-pay liability, by relying upon QR's rationale that:
 - (1) there are differences between ad hoc and additional services (as those terms are defined in the proposed SAA), in that an additional service is the same type of service as the contracted service, but an ad hoc service differs from the contracted service (e.g., it could be a service with a different origin and destination); and
 - (2) under the take or pay provisions, the access holder agrees to pay for the paths it has contracted, whether or not those paths are used,

(see QCA QR 2020 DAU Draft Decision, 134, cl. 8).

- 23 The rationale put forward by QR is fundamentally flawed because ad hoc services may well be a supply chain trial or change that leads to a productivity or efficiency improvement.
- 24 The failure to provide take-or-pay relief for ad hoc services puts an artificial cost barrier in the way of changes that support improvements to the productivity and efficiency of the rail network and ongoing sustainability of the operations of QR's customers.
- 25 To the extent the parties have negotiated take-or-pay liability, ad hoc train services should be capable of offset to take-or-pay liability and drafting amendments that define the mechanism for this should be included in the new SAA.
- 26 IPL supports Aurizon's submission that the SAA be amended to consolidate the request for additional train services and ad hoc train services under one request for extra train services and for any extra train services to be counted towards the Access Holder's annual contracted paths consumer (Aurizon Bulk Submission on QR 2020 DAU, 2.3 'Contracted pathing').
- 27 Alternatively, IPL suggests DAU2 be amended to permit an Access Holder to apply to QR to have particular ad hoc services offset an Access Holder's take-or -pay liability in defined circumstances, which application could not be unreasonably refused by QR.

Conclusion

- 28 IPL is strongly of the view that QR has not sufficiently justified that its DAU2 has had appropriate regard to the QCA's approval criteria in section 138(2) of the QCA Act. The overarching objective of Part 5 of the QCA Act is the importance of promoting competition in upstream and downstream markets (section 69E).
- 29 QR has prepared DAU2 with regard exclusively to the pricing principles in section 168A to maximise its commercial outcomes, without reference to the other, broader considerations encapsulated in the QCA's approval criteria.
- 30 IPL remains open to discussion on matters relating to its DAU2 submission by the QCA and QR. Stakeholders should be provided with an opportunity to engage in a direct forum to achieve an Access Undertaking that is balanced and workable for QR and its users and achieves the objectives of the QCA.
- 31 IPL very much appreciates the opportunity to provide this submission, and requests that this be considered by QCA as it reaches its final decision.

Yours sincerely



Seth Hobby
Executive Commercial Officer