



AUSTRALIAN RAIL TRACK CORPORATION LTD

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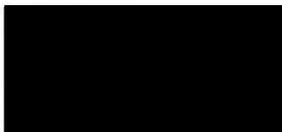
**QR Network 2009 Draft Access Undertaking
Queensland Competition Authority (QCA) Draft Decision**

ARTC Submission

Thank you for the opportunity to make a submission with respect to your Draft Decision. Australian Rail Track Corporation's submission is attached. The preparation of this submission follows substantial participation by ARTC with regard to QCA consultations in relation to the previous access undertakings to apply to the rail network in Queensland owned by Queensland Rail.

The submission contains no information considered 'commercial-in-confidence'.

For further information regarding the preparation of this submission, could you please contact myself on (08) 82174314, sormsby@artc.com.au or Mr. Glenn Edwards, (08)82174292 (Ph), gedwards@artc.com.au.



Simon Ormsby
General Manager Commercial

QR Network 2009 Draft Access Undertaking QCA Draft Decision

ARTC Submission

The QCA has published for comment a Draft Decision in relation to a proposed 2009 Draft Access Undertaking (2009 DAU) submitted by QR Network Ltd (QR Network) to apply to the below rail network assets now owned by QR Network (transferred from Queensland Rail (QR Ltd.) on 1 September 2008).

ARTC notes that the primary application of the 2009 DAU would be to the networks forming part of the export coal supply chains operating in central Queensland. Over the last 18 months, ARTC has been developing, in consultation with relevant stakeholders, its 2008 Hunter Valley Access Undertaking (HVAU), with primary application to the Hunter Valley export coal supply chain. The main focus of the consultation has been around providing for greater alignment in the commercial (contractual) arrangements between coal producers and infrastructure providers, primarily in the areas of capacity development and allocation, in order to increase certainty around access to the coal supply chain.

ARTC is proposing to put in place long term take-or-pay track access agreements directly with coal producers and other access seekers. These agreements which will underwrite long term investment in track capacity depend on coal producers having in place long term capacity commitments with terminal operators.

ARTC recognises and supports the need for contractual alignment across the Hunter Valley coal chain which will assist in increasing certainty of access for coal users and promote efficient investment in capacity expansion. To this end, ARTC has engaged in consultation with Port Waratah Coal Services in relation to assessing the extent of alignment, where applicable, in relation to the detailed provisions of the HVAU and access arrangements to be provided at the port of Newcastle. The port arrangements have now received long term authorisation from the ACCC.

ARTC believes it is important to recognise that achieving contractual alignment does not necessarily mean the contractual arrangements need to be uniform across agreements with different service providers. Doing so may unnecessarily constrain flexibility needed in relation to the provision of access by a service provider. In developing the detailed arrangements for capacity allocation, management and investment in the HVAU, ARTC has

sought to maintain sufficient flexibility to cater for the access and capacity arrangements that may be sought by other service providers. In doing so, ARTC is seeking to enable **working alignment** and consistent access arrangements between providers of different types of infrastructure and services, rather than uniform arrangements.

During the last 18 months, ARTC has made substantial amendments to many parts of the HVAU, as well as the attached Access Holder Agreement (AHA) which details indicative terms and conditions of access, in order to achieve working alignment. Areas in agreements where alignment has been considered important by the industry include:

- contracting of capacity expansions;
- compression of entitlements where capacity is under-delivered, or for unexpected delays and constraints;
- contracted entitlements in relation to track and port capacity;
- arrangements for resumption of entitlements for poor performance or under-utilisation;
- daily allocation and planning;
- development of system assumptions;
- period of allocation of capacity (monthly or quarterly)
- tolerance in utilization to allow for demand variations;
- term of agreements; and
- short term capacity trading.

It is now ARTC's view that there is a substantial degree of working alignment between its amended arrangements in the AHA and the approved port arrangements. This view is not held by all stakeholders and ARTC continues to work with stakeholders to address concerns. ARTC expects the industry to continue to push, through negotiation and through the ACCC process, for further revision of the track arrangements in pursuit of alignment.

In this regard, ARTC has indicated to the ACCC that whilst it supports achieving alignment of contractual arrangements across the coal chain, it recognises that:

- there are fundamental differences in the services provided by different service providers to the coal chain necessitating difference access arrangements; and
- the benefits of alignment to service providers are small compared to those of the producers, and ARTC cannot act outside its own reasonable commercial interests in pursuit of alignment.

ARTC further believes that structuring access arrangements across infrastructure services providers so as to achieve alignment in access arrangements, and benefits for the supply chain as a whole, may constrain the extent that any single service provider can optimize the utilization of its infrastructure and investments in that infrastructure. This is a source of risk to an investor in that infrastructure.

Recent developments in global financial markets and economies, has increased the uncertainty faced by export coal supply chain and individual elements within those chains. These developments increase risk and further constrain the ability of infrastructure providers to invest in increased capacity in these networks.

In its submission to the QCA's Issues Paper in November 2008, ARTC provided comments in relation to a number of pricing and non-pricing issues raised by the QCA. ARTC notes that the QCA has given ARTC's comments some consideration and ARTC supports many of the proposals put forward by the QCA in the Draft Decision. Further specific comments are as follows.

Pricing Related Issues

WACC

In determining an appropriate WACC, ARTC notes that the QCA have taken into consideration acceptance of a number of QR Network's proposals that are considered to reduce QR Network's risk. Examples include:

- accelerated depreciation;
- up front capital contributions;

- annual review of volume forecasts;
- annual maintenance cost adjustment using a new maintenance cost index.

To recognize this, the QCA has proposed to reduce asset beta to 0.45 which is below the range proposed by QR Network (0.5 – 0.6) and also below the asset beta approved in the 2006 Access Undertaking. ARTC accepts that the above proposals by QR Network will serve to reduce risk to some extent, but expresses some caution in over-estimating the impact on asset beta, particularly given the uncertainties in estimating asset beta in the first place due to lack of comparability. Reducing asset beta as proposed assumes that the risks that QR Network's measures seek to mitigate have been properly compensated in the first instance.

Whilst such risks are often recognized in regulatory assessments, it is ARTC's experience that these risks are rarely properly quantified and reflected in adjustments to the asset beta. This may be a reason for constrained investment in networks in the past. As such, it is important not to over-estimate (and possibly even under-estimate) the impact on asset beta of risk reducing measures, as it is not clear to ARTC that QR Network is being properly compensated for taking these risks historically.

As an example, IPART elected not to provide for any compensation for stranding risk in its most recent decision in relation to the Hunter Valley rate of return.¹ Given this, it would be difficult to justify a reduction in return in the Hunter Valley were accelerated depreciation or extension of contract life to match asset life incorporated in regulatory arrangements.

ARTC also expects that certain QR proposals may increase risk to QR Network revenues (for example, proposed changes to the incentive/disincentive arrangements around the revenue ceiling).

In relation to specific WACC parameters proposed by the QCA, ARTC is somewhat disappointed that the QCA has chosen to ignore the positions put forward by QR Network and its consultants, Synergies. ARTC considers that the arguments and evidence put forward by Synergies are both contemporary and strong and many cases support a move away from historical regulatory precedent. ARTC considers that the arguments and evidence

¹ <http://www.ipart.nsw.gov.au/files/Final%20report%20-%20NSW%20Rail%20Access%20Undertaking%20-%20Review%20of%20the%20Rate%20of%20Return%20and%20Remaining%20Mine%20Life%20from%201%20July%202009%20-%20August%202009.PDF>

put forward by Allen Consulting Group merely represent an alternative position (often to retain the status quo) but are no more compelling.

ARTC has previously supported the alignment of the basis for certain parameters with asset or investment life (as opposed to the regulatory cycle) and continues to support this.

Operating & Maintenance Costs

ARTC notes that the QCA engaged consultants GHD to assess the efficiency of QR's proposed operating costs. ARTC also notes that GHD used ARTC and Westnet Rail as the basis for benchmarking comparisons. Whilst ARTC recognizes that GHD treated the benchmarking assessment with some caution, the conclusions it drew from that assessment seemed to rely upon fairly heavily in its conclusions in relation to QR Network's proposed expenditures.

ARTC's experience in relation to the benchmarking of its own maintenance and operating expenditure against those of similar entities is that there are two sources of uncertainty, being differences in relation to the circumstances of the network involved (topography, climate, complexity, density and possession windows) as well as differences in the way expenditures are reported. Published expenditure figures rarely provide sufficient detail in relation to the formulation and aggregation on numbers, sometimes for good reason (commercial sensitivity).

In relation to the operating and maintenance figures quoted by GHD in its report, ARTC has been unable to confirm that the numbers quoted are correct, even when information in relation to the source of the numbers has been provided. In fact, assumptions made by GHD about the nature of the expenditures used would seem to be incorrect. Examples are:

- ARTC Operating Cost (06/07) – Table 3 of the GHD report. ARTC is unable to confirm the figure used from the source provided. The information in the source provided relates to expenditure associated with ARTC interstate network outside of NSW, not the Hunter Valley coal network. A unit operating cost was then determined by using an estimate of HV train kms. As such the comparator used by GHD in figure 4 would seem to be erroneous and likely to be misleading. GHD used this information to draw conclusions such as 'Allowing for differences in the way operating costs are classified between operators, the figures reveal a level of consistency across organisations. CQCR appears to be comparable if not more efficient than ARTC's Hunter Valley operation.' and 'QR

Network's costs appear reasonable in the context of publicly available, notwithstanding the foregoing comments about the limitations of benchmarking².

- ARTC Unit Maintenance Costs (\$07/08) – Figure 22 of the GHD report. ARTC is able to confirm the Hunter Valley expenditure figure used from the source provided, but advises that this figure includes all maintenance overheads and infrastructure management. According to page 9 of the GHD report, it would appear that infrastructure management expenditure is included in operating expenditure. ARTC is also unable to confirm the Hunter Valley GTK estimate used by GHD. The unit cost figure used for the ARTC non-coal network also includes infrastructure overheads. As such the unit costs shown in Figure 22 are likely to have been substantially overstated when contemplated on a consistent basis. GHD used this information to conclude 'The results reveal a general consistency between the three infrastructure managers. QR Network's maintenance cost for 2010/11 is essentially the same as that of ARTC's coal network ...'³.
- ARTC Ballast Treatment Expenditure – Figure 22 of the GHD report. ARTC is unable to confirm the expenditure unit cost from the source provided. In any event, the source quotes a 5 year \$8.9m ballast cleaning program on the Hunter Valley coal network. The program is intended to establish a regular planned maintenance and ballast cleaning cycle consistent with worldwide heavy haulage practice, following a period of around 20 years where the network had not received any significant ballast maintenance or upgrade. It is unlikely that any unit cost based on this program would reflect a 'normal' level of ballast cleaning on the network.

Due to these errors and inconsistencies, ARTC contends that some conclusions drawn by GHD are questionable.

Revenue Cap Incentives and Penalties

In the HVAU, ARTC has proposed to adopt a system-wide true up test (on a monthly basis) with an annual reconciliation as a mechanism for estimating the extent of the capacity entitlements sought by the access holder, but not made available due to the fault of ARTC upon which a rebate of the annual take-or-pay (TOP) charge would be based. Any rebate of the TOP charge resulting from this mechanism would still be deemed as revenue for the purposes of the revenue ceiling test, as such, is revenue placed at risk by ARTC.

² GHD, Assessment of Operating and Maintenance Costs for UT3', September 2009, p14.

³ GHD, Assessment of Operating and Maintenance Costs for UT3', September 2009, p42.

ARTC considers that the application of the system wide true up test places a powerful and far reaching incentive (although framed as a deterrent) to ARTC's conduct in performing its contractual obligations. Details of the test and annual reconciliation can be found in the Indicative AHA forming part of the HVAU.

The test acts as a financial incentive to ARTC:

- Not over contracting capacity in the context of prevailing maintenance requirements, non-coal commitments and coal chain system losses.
- Ensuring there is sufficient capacity available to meet contractual commitments at all times.
- Not selling more capacity than is available on an ad hoc basis.
- Not exceeding planned maintenance requirements.
- Ensuring proper estimation of available capacity for system variability (surge).
- Minimising the impact of any ARTC caused disruptions to the system.
- Ensuring temporary trading of capacity does not impact on existing capacity available to other participants.

ARTC supports the revenue cap mechanism that permits QR Network to retain 2% over the revenue cap limit if it could demonstrate that higher than anticipated volumes were a result of activities associated with improving the performance of the whole of the supply chain. ARTC considers the problems with the approach raised by the QCA are not insurmountable. Generally coal chain improvements are (or could be) well documented in terms of participants and outcomes. As such, unrelated volume effects can be discounted.

NON PRICING ISSUES

Term

The QCA indicated that all stakeholders supported the proposed four year term of the 2009 DAU. ARTC wishes to confirm that in its November 2008 submission to the QCA, ARTC indicated that it felt the four year term is somewhat shorter than may be needed in the context of the central Queensland export coal chain. ARTC's 2007 Interstate Access Undertaking and its proposed HVAU have a 10 year Term (with a five year review) and the opportunity for ARTC to review as required under certain circumstances.

ARTC indicated, however, that a term of this magnitude does represent increased risk for ARTC, given rapidly changing economic and industry circumstances in many of its markets, which ARTC has weighed up against providing increased certainty for users. ARTC will consider this risk in proposing an appropriate rate of return to the ACCC. ARTC respected QR Network's decision not to take this risk, but considers a four year term too short to provide producers with sufficient certainty in relation to their investments. ARTC would support a longer term for the 2009 DAU subject to QR Network being adequately compensated for the additional risk in its rate of return.

Access Agreements

ARTC notes the general industry support for the proposed capacity access agreement (CAA) and train operations agreement (TOA) model. ARTC has proposed a similar approach in the HVAU with an access holder agreement (AHA) and operator sub agreement (OSA). Importantly each OSA must be linked to an AHA, and an AHA can have more than one OSA linked to it. Each OSA must be properly endorsed by the access holder holding the AHA to which that OSA is related. Any operations covered by that OSA must comply with the capacity entitlements in the related AHA. Figure 1 below describes the existing contractual arrangements in the Hunter Valley, whilst Figure 2 below describes the proposed approach.

Figure 1 Existing Hunter Valley Contractual Arrangements

- No direct relationship between ARTC and coal customers.
- No certainty of existing track capacity for coal producers.
- No capability for producers to contract for future capacity.
- Operator has no mechanism to bridge gap.

Commercial objectives of parties misaligned.

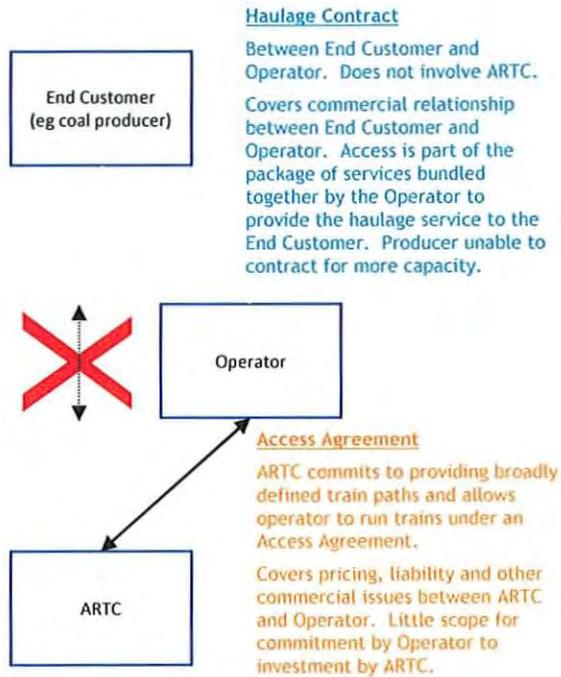
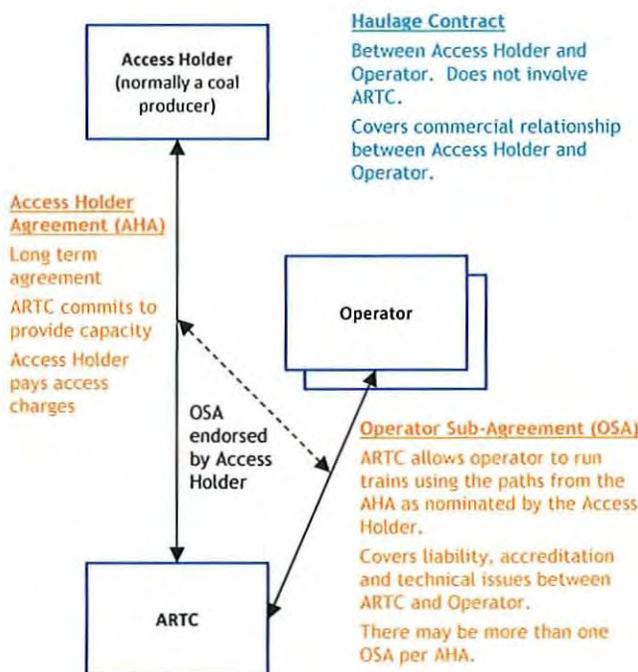


Figure 2 Proposed Hunter Valley Contractual Arrangements



- Direct relationship between ARTC and coal customers.
- Coal producers have specific existing track capacity aligned with port.
- Mechanism for producers to contract for future capacity.
- Operator no longer has to play 'middle man' role.

Commercial objectives of parties aligned.

Capacity Management Principles

System Paths

ARTC notes that the QCA has proposed to include in the 2009 DAU definition of a 'system path' presumably intended to tie the train path (the capacity that QR Network sells) to a specific coal unloading facility. Whatever the reason for contemplating a system path in any system rules, ARTC does not support the extension of the product sold by a below-rail service provider to be formally tied to the product made available by another service provider. ARTC considers alignment of contractual entitlements across the coal supply chain can be achieved in other ways, without attempting to create a 'system' product to be sold.

Capacity Resumption

ARTC notes QR Network's proposal of a 90% under-utilisation threshold determined over twelve month period, with an ability for the access holder to 'show cause' when the threshold is reached. The HVAU contains similar provisions with an 80% threshold measured over a rolling six month period, with a similar show cause provision. ARTC original proposal to the ACCC included a 90% threshold measured over a rolling three month period, with no show cause provision.

ARTC's latest proposal follows industry consultation which suggested normal system variations would trigger the threshold regularly.

ARTC considers it unlikely that the take or pay component of access pricing alone will act as a sufficient deterrent to capacity hoarding given the vast difference between the cost of access and the price of coal. Industry stakeholders largely made up of incumbents would prefer more relaxed settings, whilst the below rail access provider could be somewhat ambivalent to the settings, given that revenue is not compromised. As such, capacity resumption provisions are largely about the public benefit associated with facilitating competition in other markets.

Given this. ARTC considers that the QCA needs to satisfy itself that the proposed settings are appropriate with the competitive impacts in mind.

Capacity Transfer

ARTC recognizes and supports the need for short term transfer of capacity (trading) in the coal supply chain in for access holders to reasonably managed take or pay obligations in the circumstance of a variable market and shipping patterns. To this end, ARTC has incorporated provisions permitting short term capacity trading within and between access holder agreements for coal.

The provisions allow for what ARTC calls 'safe harbour' trades (trades that are most unlikely to have any impact on coal chain capacity and the existing entitlements of other parties). Such trades do not require ARTC approval, but ARTC seeks three days notice of such trades (aligned to the short term planning cycle).

Other trades that are likely to have some system impact will require a more detailed assessment of the impact on system capacity and the availability of capacity. Such an assessment would normally need to be undertaken by the coal chain coordinator, and advice to ARTC. For this reason, ARTC requires two weeks notice. ARTC hopes that this time frame will fall in time, as systems for quickly determining coal chain capacity impacts are established.

ARTC has also committed to working with industry to agree a system wide and streamlined system for capacity trading, but recognizes that the impact of capacity trading is different for different service providers. As an example, capacity trading at the port involves trading of tonnage with a trade unlikely to significantly impact on stockpiling. On the other hand, a trade on the rail network can have substantial impacts of available capacity and the ability to meet other network users' entitlements.

Capacity Expansion

ARTC supports QR's clarification that it will only undertake infrastructure enhancements if it can commercially justify such projects, and notes that the QCA considers that it is reasonable for QR Network to have some discretion on when it decides to expand network capacity.

The HVAU contains a similar provision, and also commits ARTC to advising the access holder of the reasons for not accepting the project, and to entering into good faith negotiations with the Access Holder with the aim of securing alternative funding arrangements to deliver that project. These are requirements are similar to that being proposed by the QCA.