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Dear John

Response to Draft Decision on QR Network 2009 Draft Access Undertaking

QRNational Coal and QR Freight (submitting a combined response as QRNational) welcome the opportunity to submit its views on the Draft Decision on QR Network's 2009 Draft Access Undertaking (DAU). The 2009 DAU is recognised as an extremely important document as its regulatory framework will form one of the key foundations for contractual arrangements and system capacity in Queensland's coal supply chains.

On the basis that QR Network is likely to withdraw the 2009 DAU as it currently stands in February 2010 and submit a replacement, QRNational will utilise this submission to identify areas where changes or additional issues need to be addressed. Some of these issues flow directly from QR Freight's Submission to the QCA dated 14 November 2008 and others have been identified in the course of day to day commercial business activities since the time of the initial submission.

QRNational recognises the need for transparency and greater clarity of the processes required to develop the detail to support the 2009 DAU's provisions, for example non-pricing issues and the new form standard contracting framework. On this basis, and as provided for by the QCA on a number of matters in its Draft Decision, it is imperative that rail operators and users are closely consulted and involved in the development of such provisions.

1. QR Network's Proposed System Rules

QRNational supports the development of System Rules which reflect the operating modes in the coal supply chains within the Central Queensland Coal Region. System Rules are seen as a key mechanism for assisting all members of the coal supply chains to work cooperatively to maximise coal throughput on each of the coal systems.

QRNational recognises that the potential application across varying generations of Access Agreements brings significant commercial and financial risks and some benefits for current Access Holders in relation to both their current Access Agreements and terms and conditions contained in existing above rail agreements. On this basis, the System Rules must reflect the interests of all Access Holders, access seekers and their customers. QRNational believes that these concerns may be in some way alleviated by the QCA's decision which requires the DAU to provide for:

- a) A detailed process for the development of System Rules;
- b) Clarity that consultation will include Access Holders, access seekers and their customers; and
- c) QCA resolution of disputes over amendments to system rules.

QRNational is also cognisant of the need for flexibility to be built into the process to enable a collaborative approach of all affected parties within the supply chain to agree any changes/amendments to System Rules over time to reflect such matters as operating mode changes. QRNational firmly believes that operators must have a role in agreeing to the development of and changes to System Rules, rather than simply a right of consultation and ultimately a right to dispute them, particularly given the significant potential impact of the imposition of System Rules which are not necessarily reflective of existing commercial terms and conditions contained in either Access Agreements or existing above rail contracts. The principle should be that anything that has the ability to materially affect another party to the agreement should be mutually agreed (as opposed to disputed after the fact). Where no agreement can be reached between the parties, the QCA may hold the final decision making capability. However, the Access Undertaking should be very clear that any party adversely financially affected by the final outcome must have the right to fair and reasonable compensation.

QRNational supports the inclusion of the additional provisions in the Access Undertaking to include:

- 1. a clearly defined process for the consultative development of System Rules and recommends that operators have a role in agreeing them rather than only having the ability to dispute them;**
- 2. a clear requirement that any party adversely financially affected by the new or varied System Rules has the right to fair and reasonable compensation.**

2. Scope of Access Undertaking (Part 2)

The QCA's Draft Decision on the 2009 DAU requires QR Network to reinstate provisions from the 2008AU (accompanied by an undertaking from the QR Ltd Board to support these obligations) that effectively compel QRNational Coal and QR Freight to transfer their infrastructure assets to QR Network in the event that it is determined that they are used to provide the declared service.

The background to these provisions stems from the lack of certainty surrounding the exact identification of assets that are required to provide the declared service. The declared service covers "rail transport infrastructure" for which QR (or a subsidiary) is the railway manager. "Rail transport infrastructure" is defined in the TIA as track and associated infrastructure, excluding "other rail infrastructure" which includes specified above rail facilities. The uncertainty of the definition relates to when track forms part of a specified above rail facilities.

During the development of the 2001AU, the Solicitor General advised Government that whether or not track forms part of a specified above rail facility depends on how the track is used, and can change over time. At that time, QR made its best possible assessment of what track is required to provide the declared service, and allocated this track to Network Access (now QR Network). However, in recognition of the potential fluidity of the scope of the declared service, the QCA required that QR's undertaking include provisions to transfer additional assets to Network Access (now QR Network) if they were demonstrated to be required to provide the declared service. No assets have been required to be transferred to Network Access or QR Network as a result of these provisions.

QRNational is extremely concerned with the continuation of these provisions, as it puts QRNational Coal and QR Freight at a competitive disadvantage compared to other operators. All operators need to have access to their own provisioning and maintenance facilities in order to be able to maintain their operations. In order to invest in and operate these facilities effectively, operators need to have confidence that they have full control over their facilities. While non-QR operators clearly have this control over any facilities that they build, the QCA's proposed position does not allow QRNational to have confidence in its ongoing control of its facilities. This is increasingly important given the growing competitiveness of the market for rail haulage services in Queensland, together with the fact that QRNational is now investing heavily in expanding its operator facilities.

QRNational recognises that the basis for this competitive disadvantage stems from the way in which services are declared under the QCA Act. QRNational's preferred position is that operator facilities be clearly defined up front, and then excluded from the declaration.

Assuming no change to the declaration, QRNational is exposed to unacceptable competitive threat. In the event that another operator can show that any of the QRNational facilities should be defined as “rail transport infrastructure”, then not only is access required to be given to that track, but the track itself is compulsorily transferred to QR Network, which removes the asset from QRNational control altogether. The removal of assets could have major implications for QRNational’s effective and efficient operation of its commercial business, leading to loss of profit and value destruction.

QRNational is strongly of the view that there should be no requirement for QRNational to forcibly transfer assets to QR Network, a separate legal entity, in any circumstances. While the QCA has clearly considered the preferences of third party operators in reaching this recommendation, QRNational questions whether the QCA has fully considered the interests of QRNational operators, as users of the declared service, in forming this recommendation, as it is required to do under s138(2) of the QCA Act.

In the event that any of QRNational's operator facilities are found to be “rail transport infrastructure” and subject to the declaration, then the QCA clearly has the right under the QCA Act to require that QR develop a specific undertaking for those facilities. QRNational believes that this is the appropriate approach to these facilities.

QRNational believes that there should be no provisions in QR Network’s Access Undertaking that forcibly require QRNational to transfer assets to QR Network. QRNational questions whether the QCA has fully considered the interests of QRNational as an operator of services.

3. Negotiation Framework (Part 4)

The QCA’s Draft Decision on the 2009 DAU endorses amendments to timeframes for QR Network’s consideration of Access Applications as follows:

- The acknowledgement period is extended from 5 to 10 days;
- Access application information requirements are to be confirmed within 10 days of lodgement;
- QR Network has an option to extend the 30 day timeframe for issuing Indicative Access Proposals (IAPs) up to the first 20 days of receiving the access application by another 30 days; and
- Any extension for issuing an IAP beyond the first 20 days of receipt of an access application would require the approval of the access seeker.

It is unclear to QRNational under these amended timeframes what happens if an access seeker objects to QR Network’s request for extension of the issuing of the IAP where the request is made beyond the first 20 days of QR Network’s receipt of the access application. QRNational continues to be of the belief that the current and proposed arrangements in the 2009 DAU do not provide any incentive for QR Network to deal with an access application in a timely manner.

QRNational questions how the 2009 DAU provides any certainty for access seekers in terms of timely management of access requests and recommends the clear documentation of timeframes for the lodgement, extension and completion of IAPs.

4. Capacity Holder Standard Access Agreement

QRNational is cognisant of the desire for some of its customers to gain long term security over the access entitlements for their mines and understands that the development of a Capacity Holder Access Agreement would allow coal companies to hold the capacity rights without also needing to take on responsibilities for all the train operation/service obligations. On this basis, QRNational supports a capacity holder access agreement but does not necessarily believe it has to take only one form of agreement. Advantage is seen in allowing greater flexibility on the form an access agreement can take as preferences may differ dependent on a mine’s needs.

QRNational notes the QCA’s proposed framework for the development of the Capacity Holder Standard Access Agreement (CHAA) that details the circumstances in which QR Network will develop new standard access agreements and the process to be followed. It is noted that under the process QR Network will consult with all

stakeholders in the coal master planning forum in the period during the nine months following the commencement of the 2009 DUA.

QRNational believes there are a number of key issues which it is imperative be addressed during this consultation and development process, including but not limited to:

- Alignment between the capacity sought and negotiated by the capacity holder for below and above rail capacity;
- Determination of above and below rail capacity and how they will impact on capacity levels (i.e. varying train configurations as compared to the reference train);
- Operation of ad hoc services and the take or pay implications of these services;
- The introduction of a performance management culture, with the intent not to introduce penalty/incentive payments, but to foster a climate where performance measures are shared and discussed with a view to developing plans to address downward trends;
- The need for greater balance in the risk sharing and obligations across the parties; and
- The need for clarification of methodology for calculating key metrics/charges within the agreement.

QRNational:

- **supports an open and transparent consultative process in the development of a capacity holder access agreement but does not believe it has to take only one form of agreement;**
- **recommends the endorsement of the proposed agreements through the mechanisms contained in the 2009 DUA.**

5. Reference Tariffs (Schedule F)

5.1 Socialisation of AT5

The QCA's rejection of socialising the AT5 tariff across the Goonyella and Blackwater systems has both short and long term implications for QRNational as an operator.

- In the short term, QRNational is certain that the increase to \$4.25/000egtk for the AT5 tariff in Blackwater will make diesel trains a cheaper solution for some customers than electric trains. In this case, QRNational's electric fleet is threatened with stranding as rolling stock plans were made, including major investment in new and rebuilt electric locomotives, to support QR Network's planned full electrification of Blackwater (excluding Rolleston and Minerva). QRNational contracts were also written with the understanding of a predominantly electric system, and do not have the flexibility to allow for a change in below rail pricing for diesel operated services. Cycle times will also increase with increased use of diesel consists, and system capacity will fall in response.
- In the long term, the QCA's decision threatens the achievement of any real benefit to operators and users from QR Network's new investment in the Blackwater system's electric capacity. The significant increase in AT5 tariff creates a misalignment of incentives where the short term incentive for customers will be to request diesels in Blackwater; but the long term incentive for all customers and operators is a more efficient electrified system which is achieved by maximising the utilisation of the Blackwater electric system and encouraging operators to further invest in electric locomotives. The total average costs for an electrified system will fall over time as utilisation increases, which is the long term goal of any supply chain.
- QRNational is also highly concerned that the QCA's decision threatens future investment in QR Network's electric capacity in any other system, including the Goonyella system. Having invested heavily in four new substations in the Blackwater system, QR Network will have a very strong incentive to ensure that electric utilisation of that system is maintained at the level assumed for the investment. Given that there is no take or pay on AT5 linking to the geographical operation of electric trains, the only way that QR Network can avoid operators transferring the electric locomotives to another, cheaper, system is to avoid having available electric capacity in another system. QRNational questions how QR

Network can ever commercially invest further money in the Goonyella system, unless it is assured that this will not result in stranding of its new assets in the Blackwater system.

From QRNational's perspective electric locomotives are more efficient, provide greater capacity, and have lower costs to maintain. As such, QRNational supports the long term goal of system electrification for both supply chain and operator benefits.

As the \$2.37/000egtk rate for AT5 under socialisation does not make electric consists unviable in Goonyella (i.e. does not breach the bypass cost of diesel), the socialisation solution does not threaten long term electric investment in either system. However, not allowing socialisation does endanger the long term goal of efficiency in Blackwater and future expansion of electrification in Goonyella.

QRNational also agrees with the earlier submission of the QRC with regards to green field projects, such as GAPE. These future assets should be dealt with through a separate regulatory process as the implications of socialisation may vary in each case.

QRNational recommends the QCA address in greater detail the issue of long term investment in the coal network's electric assets and the potential short term stranding of operator assets in light of their earlier decision.

5.2 Capping of UT1 Take or Pay

As already noted by QR Network, Take or Pay (ToP) revenue was not intended to exceed the Revenue Cap when it was introduced under UT2. QRNational agrees with QR Network that ToP is not meant to result in windfall revenue for QR Network, though the current Undertakings allow for this to occur.

QRNational is concerned that the risk of UT1 ToP triggering has increased with the introduction of UT2 as some of the potential mitigations that existed within UT1 have been eliminated. The impact of this change in risk on QRNational's interests has not been adequately addressed by the QCA. Under the Queensland Competition Authority Act (1997, Section 138:2e), the QCA is obligated to consider QRNational's interests in regulating *"including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected."*

As the treatment of UT1 ToP has a significant impact on QRNational's business, the QCA should consider carefully the change in commercial exposure for ToP between UT1 price regulation arrangements and the subsequent changes under UT2.

For UT1 Access Holders the exposure to ToP has changed under UT2 triggers because:

- 1) UT1 was based on a constrained price cap form of regulation. The reference tariffs were applicable while actual volumes remained within a 10% cap and collar of the original forecast. If volumes varied by more than +/- 10% of the original forecast, the reference tariffs, including the volume forecast, were to be reset. As such, it was reasonable for QRNational to assume that volumes would not fall more than 10% below the original forecast for any sustained period of time. Under UT2, QR Network's financial exposure to volume is dealt with by the Revenue Cap. Therefore, UT2 no longer provides for tariffs and volume forecasts to be reset if they vary by more than 10% of the original forecast. As a result, an important protection against triggering UT1 ToP was removed in UT2. QRNational made the decision to take the risk of UT1 ToP with the understanding that this protection was in place.
- 2) UT1 volume reset triggers were based on cluster performance. That is, tariffs were set on a cluster basis and the price review triggers were based on a variation of +/- 10% of cluster forecasts. As the trigger for ToP is System Gtk, this cluster reset could avoid the system being triggered for ToP if under raiiling was concentrated in one cluster of the system. A system could now fail the System Gtk test under the UT2 provisions due to an individual cluster which would not have failed under the UT1 reset rules.

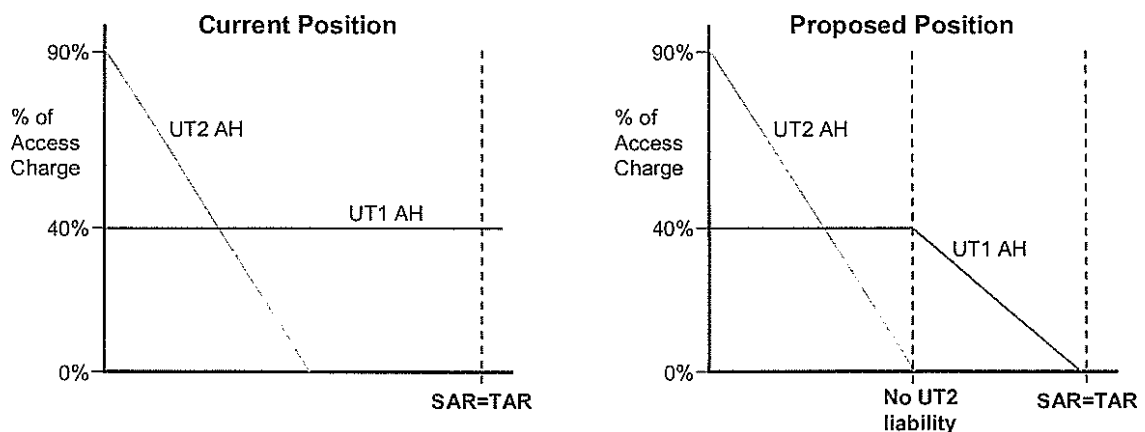
- 3) The UT1 volume forecasts for QR Network were quarterly, and were not required to be uniform across the year. Access Holders could then account for seasonal fluctuations and variable ToP was triggered based on performance against these quarterly targets. With the introduction of the Revenue Cap in UT2, only annual forecasts were used and they were evenly divided across the 12 months of the year. With the even division of annual tonnes, as opposed to quarterly, variable ToP could be triggered early in a year where large volume growth occurs. The large volume growth later in the year will meet the annual System GtK test, but the variable ToP triggered earlier may not be offset by this increase. Whereas under the original UT1 volume forecasting, variable ToP may never have been triggered.

Under the arrangements that applied for UT1, there were real protections against volumes being substantially below system forecast for any sustained period of time. On this basis, QRNational made a commercial decision to accept the risk of ToP in a number of its rail haulage contracts, and not pass this exposure on to its customers. However, these protections were eliminated in UT2 when the form of regulation changed to Revenue Cap regulation. While the QCA clearly considered the impact of volume risk on QR Network in making the decision to accept Revenue Cap regulation, it did not appear to consider the impact on QRNational's above rail businesses in eliminating the protections against sustained triggering of high levels of UT1 ToP. As a direct result of this change QRNational's ToP exposure has skyrocketed during UT2, reaching more than \$30 million in 2008/09.

As the commercial exposure negotiated for ToP under UT1 has increased for Access Holders under UT2, QRNational is seeking a means to return to an equivalent net risk position as was originally negotiated.

QRNational recognises that it is difficult, if not impossible, to return to the exact same ToP risk position as existed in UT1. However, QRNational believes that there are some simple measures that can be adopted in UT3 which can provide broadly equivalent mitigants for UT1 ToP.

QRNational proposes that the most appropriate method for returning Access Holders to their original position is to reduce UT1 ToP proportionally to balance the System Allowable Revenue/Total Allowable Revenue equation after all of the UT2 liabilities have been reduced (as illustrated in the figures below assuming 90% and 40% liability for UT2 and UT1 Access Holders respectively). This is in line with the intent that UT2 contracted paths are consumed after UT1 contracted paths, so UT2 Access Holders should have their liability reduced in the first instance. It is also does not interfere with the explicit capping of UT2 liabilities, while allowing for capping of UT1 as compensation for the increased commercial exposure.



Alternatively, if UT1 ToP capping is not endorsed by the QCA, QRNational proposes that the original cap of 10% of system volume is reinstated for UT1 Access Holders with regard to ToP. In this instance a UT1 Access Holder contracted for 100 million tonnes would pay ToP against 90 million tonnes if the System GtK test triggered ToP.

QRNational:

- does not believe Total Allowable Revenue should exceed System Allowable Revenue due to any ToP payments;
- recommends UT1 ToP liabilities be reduced proportionately after UT2 ToP liabilities have been reduced to zero, in order to make SAR=TAR;
- in the alternative, recommends returning UT1 Access Holders to the original position of a 10% system volume reset for ToP purposes.

5.3 Maintenance Costs

The QCA's Draft Decision rejects QR Network's submission of inflated maintenance costs. QRNational is highly concerned about the implications of this rejection for train operations and the ability of QR Network to manage an efficient rail system. If QR Network can only recoup maintenance costs which are lower than realistic market value, it will be put in a position to cut costs at the expense of network capacity.

For example, QR Network currently plans for two 12 hour maintenance shutdowns each month in Blackwater. If increased maintenance costs are not allowed, these closures may be spread out further as overtime labour will not be possible. Instead of two 12 hour shut downs operators may have to plan around three 8 hour shutdowns a month, which will cause a greater disruption to train operations and increased operating costs as train operations are ramped up and down more frequently.

In addition, maintenance costs will determine the level of maintenance provided by QR Network. If the maintenance budget is insufficient, QRNational anticipates speed restrictions will increase in response as maintenance levels fall behind demand on the network. Speed restrictions decrease system capacity and QRNational's ability to deliver to contracts. Increased speed restrictions will also lead to increased operating costs for QRNational, particularly with regards to increased crew requirements.

QRNational supports an increase in QR Network maintenance costs to:

- cover the full scope of maintenance works proposed by QR Network, and
- to increase in line with appropriate inflation rates, as the increased costs and decreased capacity of lower maintenance costs may significantly harm QRNational's business interests.

If you have any further queries or require more information please feel free to contact Susan Glenn, Acting National Access Manager on telephone 07 3235 7849.

Yours sincerely



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