



20 January 2014

Mr Paul Bilyk  
Director, Rail and Ports  
Queensland Competition Authority  
GPO Box 2257  
Brisbane Qld 4001

By email: rail@qca.org.au

Dear Paul,

### **QCA Cost of Capital Discussion Papers**

Vale Australia Pty Ltd (**Vale**) welcomes the opportunity to provide a submission to the Queensland Competition Authority (**QCA**) in respect of the QCA's discussion papers on

- Response to submissions on the Risk free Rate and the MRP
- Estimating Gamma
- A Cost of Debt Estimation Methodology for businesses regulated by the QCA
- Review of Regulatory Capital Structure and Asset/Equity Beta for Aurizon Network

Vale has been an active participant in the Queensland Resources Council's (**QRC**) efforts to develop an agreed industry position regarding these discussion papers. We note the QRC will be submitting an industry submission, from these discussions, to the QCA and Vale takes this opportunity to support the QRC's submission to the QCA. Vale supports a consistent approach and application of the traditional methodology adopted by the QCA and all other Australian regulators (based on CAPM) for determining appropriate rates of return, and that this methodology will provide appropriate returns to the providers of debt and equity. Vale does not plan to outline detailed analysis in this submission or general comments on most of the papers as it supports the detailed analysis and issues identified in the QRC submission. Vale does provide some additional comments on the discussion paper on Asset/Equity Beta for Aurizon Network.

Aurizon Network's (**Aurizon**) view of their Equity Beta has always been a subject of discussion and debate as it plays a critical role in determining the appropriate return on investment that is commensurate with its regulatory and commercial risk. As noted in the Incenta report there is very few comparable businesses that can be used to provide a reference as to the appropriate Equity Beta to be applied to Aurizon. Vale, along with industry, has argued for some time that the current Equity Beta being applied to Aurizon should be lowered to reflect what Vale believes is a reduction in the level of risk over the undertaking periods, and a potential further reduction of this risk in the 2013 Draft Access Undertaking.

Vale notes that one of the key points in the Incenta report is to increase the sample size of comparator entities to be used in benchmarking the appropriate Asset/Equity Beta for Aurizon.

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Vale Australia Pty Ltd ABN 17 062 536 270  
Level 11, 100 Creek Street, Brisbane Queensland 4000  
GPO Box 731, Brisbane Qld Australia 4001  
Tel +61 7 3136 0500 Fax +61 7 3136 0510

Aurizon has proposed that US Class 1 railroads should be used as a comparator to Aurizon but Incenta have discounted these firms as an appropriate benchmark as they do not show similar characteristics to Aurizon. Vale supports this view on the US Class 1 railroads and would also argue that toll road businesses should be excluded as they operate under different characteristics to Aurizon.

Vale would argue that DBCT is the closest comparator to Aurizon given it is subject to a similar regulated revenue cap under the QCA and operates in the coal industry. Vale believes this must be a strong influence as a benchmark for Aurizon but acknowledge that the inclusion of power and water businesses provides a larger sample size of valid comparators.

Vale believes the inclusion of businesses within the sample must still be based on a first principles assessment of the business characteristics to determine if it is an appropriate comparator for Aurizon and not be driven only by a desire to increase the sample size of the comparators. Vale supports the view in the QRC submission that the current power and water businesses would provide an upper limit for the Asset/Equity Beta for Aurizon as we believe Aurizon's level of risk is lower than these power and water businesses.

For further information regarding this advice please contact myself on (07) 3136 0911.

Yours sincerely,



Bob Skuza  
Manager Logistics  
Vale Australia Pty Ltd