

New Hope Corporation Limited



New Hope
Corporation Limited

Submission on Queensland Rail's 2015
Draft Access Undertaking

Volume 1

Introduction to NHC Submissions &
regulatory framework

5 June 2015

1 Introduction

The process of developing and approving a new undertaking for Queensland Rail (**QR**) has been long and somewhat depressing one. Three previous Draft Access Undertakings (**DAUs**) were withdrawn by QR, numerous extensions have been provided and now a fourth DAU (the **2015 DAU**) has been submitted by QR which, in our view, cannot be approved. The 2015 DAU remains inappropriate

New Hope Corporation Limited (**NHC**) is pleased that the latest DAU has been provided following the issuing of an Initial Undertaking Notice by the Queensland Competition Authority (**QCA**). It is hoped that this latest process will ultimately lead to the development of an undertaking which will promote efficient use of the Western System and which appropriately balances the interests of all stakeholders. Clearly it is in the interests of all stakeholders that the long-running uncertainty surrounding the price and terms of access to the West Moreton system be resolved.

NHC considers that it is not appropriate for the QCA to approve QR's 2015 DAU under section 138(2) of the QCA Act for the reasons set out in its submissions. Accordingly it requests that the QCA make a decision to refuse to approve QR's 2015 DAU and set out the ways in which the 2015 DAU should be amended, in accordance with section 140 QCA Act.

2 Structure of NHC Submission

This submission is provided in five volumes, as follows:

- (a) **Volume 1** (this document):
 - (i) An introduction and overview of NHC's submissions on the 2015 DAU; and
 - (ii) Submissions on the regulatory framework applicable to the QCA's consideration of the 2015 DAU and the role and powers of the QCA
- (b) **Volume 2**: Submissions on the proposed West Moreton coal Reference Tariffs.
- (c) **Volume 3**: Submissions on all elements of the 2015 DAU other than reference tariffs and the Standard Access Agreement.
- (d) **Volume 4**: Submissions on QR's proposed Standard Access Agreement.
- (e) **Volume 5**:
 - (i) Responses to the queries raised in the QCA's request for comments paper of 15 May 2015; and
 - (ii) Additional submissions in relation to Adjustment Charges and the time period in which the new tariffs should apply.

3 Overview of NHC Submissions

NHC considers that QR's 2015 DAU is not appropriate having regard to each of the matters set out in section 138(2) *Queensland Competition Authority Act 1997* (Qld) (the **QCA Act**). In particular, it fails to give sufficient weight to the following matters in section 138(2) QCA Act:

- (a) the object of Part 5 of the QCA Act – particularly regarding the efficient operation of and use of significant infrastructure (not just investment in infrastructure by QR);
- (b) the public interest;
- (c) the interests of persons who may seek access to the service (not just the interests of QR as owner and operator which appears to be QR's sole focus);
- (d) the pricing principles mentioned in section 168A – include not just 168A(a) that QR incorrectly asserts is somehow a 'cornerstone' or 'paramount' but principles such as that

in 168A(d), namely to 'provide incentives to reduce costs or otherwise improve productivity'; and

- (e) any other issues the authority considers are relevant.

As is evident from QR's supporting submissions, QR seeks to instead give its own interests and earning what it considers an appropriate return on investment, a priority and paramount status that is not reflected in the regulatory framework which guides the QCA's consideration of the 2015 DAU.

NHC's submissions contain a wide variety of suggestions about how the 2015 DAU should be amended in order to be appropriate for the QCA to approve (after properly weighing up the factors to be had regard to in section 138(2) QCA Act). Those suggestions particularly concern the West Moreton system tariff, adjustment charges to apply the tariff to 1 July 2013, the investment framework and standard access terms.

In regard to the proposed tariffs, NHC strongly objects to:

- (a) QR's proposed reference tariff of \$19.41/000 gtk.
- (b) QR's proposed 'ceiling tariff' of \$34.92/000 gtk.
- (c) QR's attempt to define the QCA's role as being limited to the determination of a notional tariff which will have no relevance to actual tariffs for the term of the undertaking, while suggesting that QR should be entrusted with the determination of the actual tariff.
- (d) The methodologies which QR adopts in order to justify its claims.

The proposed tariff is more than double that of NHC's Australian competitors, yet relates to the poorest quality below rail asset; an asset which causes NHC's above rail costs to be in the order of ■% higher than the average of its competitors on a cents per net tonne kilometre basis. QR suggests that the QCA's role is to determine a ceiling tariff based on QR's preferred methodology, and not to concern itself with matters such as the competitiveness of the actual tariff. We strongly disagree. The competitiveness of the tariff and the impact which this has on the competitiveness of current and potential users of the system is clearly relevant to the matters under s. 138(2)(a),(d),(e) and (h) of the QCA Act. It is key to whether the tariff is appropriate and will result in efficient use of the infrastructure.

The consideration of the reference tariff for QR under the new undertaking did not begin with the 2015 DAU. In fact, the process was at an advanced stage in October 2014 with the release of the QCA's draft decision on the 2013 DAU ("the 2014 Draft Decision"). While we understand the need for the 2015 DAU to be considered on its merits, the key issues remain the same. The 2014 Draft Decision reflected the considered views of the QCA following a rigorous examination of the issues and an extensive consultation process; a process which included the additional step of issuing a Consultation Paper on pricing issues. QR's rejection of the vast majority of the QCA's 2014 Draft Decision is extremely unhelpful and disappointing. The proposed ceiling tariff of \$34.92/000gtk, when compared to tariff proposed in the 2014 Draft Decision of \$14.29/000gtk, demonstrates the extent of QR's failure to seek to resolve this issue.

NHC expects that a properly developed building block approach which addresses the above concerns will result in a tariff which is competitive and sustainable and which will not result in further loss of volumes on the system. NHC considered that the tariff presented in the 2014 Draft Decision was at the top end of the range which could be said to achieve these objectives.

The QCA has the powers it needs to require an appropriate undertaking to apply to QR's rail infrastructure, and it is critical for the West Moreton system coal producers that this opportunity to require an appropriate undertaking is not lost.

While QR has revised the 2015 DAU from previous DAUs, many of the remaining issues have been longstanding ones throughout the entire regulatory process. NHC considers that the majority of its previous submissions remain relevant – such that although this is a new process they are attached in Annexure B for consideration by the QCA as part of this process.

4 Regulatory framework

4.1 Overview

This Volume of NHC's submission responds to Section 3 of Volume 1 of QR's supporting submissions, in which QR outlines its view of the regulatory framework in which the QCA is to consider the 2015 DAU and the QCA's role.

NHC does not agree with QR's apparent interpretation of the QCA's role in assessing a DAU.

NHC's view, supported by legal advice from Allens (enclosed as Annexure A to this volume) is that:

- (a) the QCA has a wide discretion when determining whether it is appropriate to approve an undertaking;
- (b) the QCA is, relevantly, only limited by:
 - (i) the requirement to approve an undertaking which it considers 'appropriate' after it has 'had regard to' the factors set out in Section 138(2) of the QCA Act;
 - (ii) the requirements to consult, invite and take into account submissions received (and otherwise provide natural justice more generally); and
 - (iii) the QCA not having a right to refuse to approve a DAU only because the QCA considers a 'minor and inconsequential' amendment should be made to a particular part of the undertaking;
- (c) contrary to QR's assertions regarding section 168A(a) QCA Act, no single factor listed in section 138(2) QCA Act is 'a cornerstone requirement', or a dominant or paramount factor that is required to be given greater weight;
- (d) the QCA has the power to approve an undertaking which is inconsistent with any of the factors set out in section 138(2), including any of the pricing principles set out in section 168A QCA Act. This is demonstrated by the fact that section 138(2)(f) specifically acknowledges the possibility that existing assets may be excluded for pricing purposes, and requires the QCA to consider the effects of such a decision;
- (e) in fact, the QCA must seek an undertaking which is inconsistent with a pricing principle in Section 168A if it would be appropriate to do so, having regard to all of the section 138(2) factors;
- (f) the QCA is not bound to follow any particular regulatory precedent and, while the QCA may often do so, the QCA must not follow a precedent if to do so would result in the approval of an undertaking which is not appropriate having regard to the factors set out in section 138(2); and

- (g) the Western Moreton system has a range of unusual characteristics, such that, in NHC's view, it is unlikely that simply following the most commonly used asset valuation approach will be appropriate.

4.2 When the QCA can reject a DAU

NHC strongly disagrees with QR's assertion that "the QCA cannot reject a draft access undertaking because the QCA or stakeholders would prefer to address the factors in section 138(2) by a different means" (page 4, Volume 1).

As noted above, the test for approval is not whether the DAU can be said to address each of the factors to some extent (which would include a limited extent). Rather, the test is whether the QCA considers it "appropriate" to approve the undertaking, after having had regard to the listed factors. In a situation where a DAU can be said to address each of the factors to some extent, while an alternative approach would address the factors to a significantly greater extent, we consider that the QCA may rightly come to the conclusion that it is not appropriate to approve the undertaking.

QR goes some way towards recognising this point when it states (Page 4, Volume 1) "The QCA must turn its mind to each of the factors in that section to see whether the draft undertaking deals with them '**adequately**' and consistently with the object of Part 5 of the QCA Act" (our bolding). We would suggest that it is clear that a proposed undertaking does not adequately address the criteria if an alternative approach is available which is significantly superior in terms of the factors.

A review of past regulatory decisions makes this point very clear. In rejecting a draft undertaking, a regulator will normally provide a long list of 'decisions', each suggesting an amendment which ought to be included in a new DAU. These decisions are rarely based on the regulator claiming that the original proposed approach failed to meet a specific factor. Rather, the vast majority of changes sought are sought on the basis that an alternative approach would be more appropriate, having regard to the factors.

We agree with QR's views on this point only to the extent that QCA should not reject a proposed approach in order to propose an alternative approach which is appropriate (having regard to the factors) to no greater an extent, or to a greater extent where the difference is trivial. This is reflected in section 138(5) of the QCA Act "*The authority may not refuse to approve a draft access undertaking only because the authority considers a minor and inconsequential amendment should be made to a particular part of the undertaking*". This is the only relevant restriction on the wide power of the QCA to reject an undertaking which it does not consider is "appropriate" to approve, having had regard to the factors. That is, it is clear from the structure of section 138 (including the limit in section 138(5)), that the QCA is empowered to require any change it considers appropriate beyond that limit.

4.3 The relevance of the pricing principle in section 168A(a)

NHC strongly disagrees with QR's description of the status of section 168A QCA Act, particularly the statement (page 5, Volume 1) that "*The reference tariff must deliver to the access provider at least its efficient costs and a return as required by section 168(A). Anything less should not be approved and cannot be imposed*".

Firstly, we note that QR has itself proposed a reference tariff which (if all of QR's other assertions were believed) this statement suggests should not be approved, as it is below QR's

claimed ceiling price at which QR would recover its efficient costs and return.

More importantly, the pricing principles in section 168A is just one of the factors to which QCA must "have regard to" under Section 138 when deciding whether it is appropriate to approve an undertaking. It is not the only factor, and it does not have a special or "cornerstone" status within the Act as QR is seemingly asserting.

Regulators can and do reach decisions which "offend" or are not strictly consistent with one or more of the pricing principles in section 168A. In fact, if, when assessing a draft undertaking and having regard to all of the factors in Section 138(2), it would not be appropriate to approve an undertaking which is consistent with an individual pricing principle in section 168A, the regulator is bound to reject the undertaking. Ultimately, where an Initial Undertaking Notice has been provided and a DAU is not submitted which is "appropriate" having regard to the criteria, the regulator may impose an undertaking which is appropriate, including an undertaking which offends or is inconsistent with a particular pricing principle.

In QR's case, it is NHC's expectation that a properly assessed reference tariff which is consistent with section 168A will be well below the tariff proposed by QR, and may be at a level which can be considered appropriate having regard to all of the factors of section 138. However, this may not always be the case. For example, if a tariff consistent with earning a full return of the type described in section 168A(a) would be likely to induce a substantial reduction in demand, then we would consider that the approval of an undertaking containing such a tariff would not be appropriate, because it would:

- (a) not be in the public interest, due to detrimental effects on employment, taxes, royalties and competition in the coal market;
- (b) not be in the interests of persons who may seek access to the service;
- (c) not be consistent with the object of Part 5 of the Act, as it would not promote the efficient use of significant infrastructure; and
- (d) arguably not be in QR's interests, as perpetuation of the "death spiral" will ultimately result in a stranding of the assets.

In such as case, it can be seen that there is a degree of conflict between section 168A (as interpreted by QR) and the other factors which the QCA must consider. The regulator then has no choice but to approve or impose an undertaking which offends at least one of the factors, and must therefore apply more or less weight to each factor in order to determine the form of an "appropriate" undertaking.

4.4 The relevance of regulatory precedent

We strongly disagree with QR's statement (Page 5, Volume 1) that "*The QCA must assess the reference tariff proposed by an access provider and the inputs used to arrive at it against commonly accepted standards that are consistent with regulatory precedent*".

It is reasonable to expect that the QCA will have regard to commonly accepted standards and regulatory precedent. However the QCA is not bound to follow regulatory precedents, and must not do so in circumstances where following a precedent would result in the approval of a DAU which the QCA does not consider is appropriate having regard to the factors in section 138 QCA Act. A 'slavish' following of regulatory precedent would be inappropriate.

Regulators can and do apply a range of approaches when applying the same statutory criteria to different situations.

We note the references to previous decisions based on DORC valuations in the PricewaterhouseCoopers (*PwC*) reports which forms part of QR's supporting submissions to

the 2015 DAU. NHC accept that this is the most common approach applied by regulators. However, a wide range of modified DORC or non-DORC approaches have also been applied.

The West Moreton System has a number of unusual features, including mixed commodity traffic, assets not built for coal traffic and which are obsolete and life expired, impacts of the metropolitan passenger system, and substantial excess capacity. Given these factors, it would not be surprising in the slightest to find that some departure from the most common approach is required in order to develop a tariff which is appropriate for the circumstances.

In fact, given the circumstances of the West Moreton system, it would be surprising if mindlessly following the most common approach did produce a tariff which was appropriate. We note that the UNIQUEST Report disclosed by the QCA considers a range of other methodologies can be appropriate and within the QCA's powers.

4.5 A 'fresh set of eyes'

We agree that the 2015 DAU must be assessed on its individual merits and with "a fresh set of eyes". However, that does not mean that the QCA is somehow bound to reach a different position – particularly if the underlying circumstances remain the same.

We note that QR has sought to justify many of its positions and claims (including in regard to costs) simply by referring to the QCA's support of similar positions and costs in the draft decision. Clearly, stakeholders (including QR) will have certain expectations based on the draft decision, which reflected the QCA's views following an extensive consultation and assessment process.

To the extent that the draft decision on the 2015 DAU differs from the 2014 draft decision, we suggest that the draft decision should explain the different facts which were taken into account or, if the facts have not changed, the reason for the QCA revising its views.

4.6 Conclusions on the QCA's role

NHC does not agree with QR's unfounded assertion that it is "strongly arguable" that the QCA's Draft Decision on the 2013 DAU failed to meet the statutory requirements.

The draft decision clearly set out the reasons for the QCA's draft decisions, and linked these to the statutory criteria.

The task before the QCA is to once again determine an appropriate undertaking and it should not shy away from doing so on the basis of the various assertions raised by QR about the QCA's role.

Annexure A – Allens' advice regarding role of the QCA

Allens

Riverside Centre
123 Eagle Street
Brisbane QLD 4000 Australia
T +61 7 3334 3000
F +61 7 3334 3444
www.allens.com.au

GPO Box 7082
Brisbane QLD 4001 Australia
DX 210 Brisbane

ABN 47 702 595 758

Allens > < Linklaters

5 June 2015

Sam Fisher
General Manager Marketing & Logistics
New Hope
3/22 Magnolia Drive
Brookwater Queensland 4300

Dear Sam

Role and powers of the QCA in considering the 2015 DAU

1 Background

In May 2015 Queensland Rail Limited (**QR**) submitted to the Queensland Competition Authority (**QCA**) a draft access undertaking in relation to QR's rail network (the **2015 DAU**).

In QR's supporting submissions to the 2015 DAU, QR made a number of assertions regarding the QCA's role and powers in considering the 2015 DAU, including the following:

- (a) 'In considering what is "appropriate" the QCA cannot reject a draft access undertaking because the QCA or stakeholders would prefer to address the factors in section 138(2) by different means. The QCA must turn its mind to each of the factors in that section to see whether the draft undertaking deals with them adequately and consistently with the object of Part 5 of the QCA Act. If it does, the QCA must approve the draft access undertaking – the QCA cannot impose a different access undertaking to achieve the same objectives.'
- (b) 'The requirement in section 168A(a) is a cornerstone requirement in support of the object of Part 5 of the QCA Act Any decision by the QCA on reference tariffs and other pricing aspects of an undertaking that fails to meet the requirement in section 168A(a) would run contrary to the object of the QCA Act.'
- (c) 'The QCA must assess the reference tariff proposed by an access provider and the inputs used to arrive at it against commonly accepted standards that are consistent with regulatory precedent. That reference tariff must deliver to the access provider at least the efficient costs and a return as required by section 168A(a). Anything less should not be approved and cannot be imposed.'

You have asked us to advise on the QCA's role and power in determining whether to approve or refuse to approve an access undertaking, with particular reference to the assertions made by QR.

2 Determining the 'appropriate' undertaking

The QCA may approve a draft access undertaking only if it considers it appropriate to do so having regard to each of the factors specified in section 138(2) of the QCA Act.

In determining whether a draft access undertaking is appropriate, the QCA must:

- (a) have regard to each of the matters specified in section 138(2) QCA Act (s 138(2) QCA Act), which includes a specified list of factors and 'any other issues the authority considers relevant' (section 138(2)(h) QCA Act);
- (b) have published the draft access undertaking, invited submissions on it and considered submissions received within the permitted time (s 138(3) QCA Act);
- (c) otherwise provide natural justice to all stakeholders; and
- (d) not refuse to approve a draft access undertaking only because the authority considers a minor and inconsequential amendment should be made to a particular part of the undertaking (s 138(5) QCA Act), with minor and inconsequential amendment, in relation to part of a draft access undertaking, meaning an amendment that, if made, would have no real effect or consequence in relation to that part of the undertaking and the undertaking as a whole (s 138(6) QCA Act).

Outside of those requirements, the QCA has a very wide discretion as to how it determines what is an appropriate form of access undertaking.

There is nothing in the QCA Act which supports QR's assertion that QR's draft access undertaking has some sort of default or de-facto standing such that the QCA's views as to the more appropriate position are not relevant once some degree of appropriateness is passed. In fact, section 138(5) QCA Act clearly suggests the opposite, that that is only the case where the only issues separating the QR draft access undertaking and the QCA's determination of the appropriate position are 'minor and inconsequential amendments'.

In all other cases the QCA is entitled to determine what it considers the appropriate position and make a decision to refuse to approve QR's draft access undertaking if it does not align with that position.

If any stakeholder (including QR) disagrees with the QCA's assessment of appropriateness, that is an issue that goes to the merits of the QCA's decision. The QCA's decision cannot be challenged under the *Judicial Review Act 1991* (Qld) on that basis unless the decision is so unreasonable no reasonable decision maker could have made that decision, which is an extremely high threshold.

3 'Failure' to meet the pricing principle in s 168A(a)

In relation to QR's assertions regarding section 168A(a), the first key point is that section 138(2) QCA Act does not impose a list of mandatory conditions that must be satisfied before an undertaking can be approved.

Rather, it specifies a number of matters which the QCA must 'have regard to'.

This is important in understanding the relevance of the section 168A pricing principles, because (as one of the factors the QCA must 'have regard to' under section 138(2)(g)) the only requirement of the QCA Act is that they be taken into account and considered in making the appropriate decision about whether to approve or refuse to approve an undertaking.

There is no requirement in the QCA Act that the appropriate decision is consistent with or gives priority to any particular one or more of the factors to which regard is to be had. The Authority's role is clearly specified in the QCA Act as one involving balancing of a number of factors to reach an appropriate decision on a draft access undertaking. Consequently, a particular factor may be given less weight, or departed from, or not followed, in what the QCA ultimately determines is the appropriate decision on the relevant draft access undertaking.

In fact, it is clearly evident on a review of the factors to be taken into account (as set out in section 138(2)) that the QCA Act is not intended to provide for the QCA to follow or ensure its decision is

absolutely consistent with all of the factors to be had regard to – as there is often a clear tension between some of the factors. To mention the obvious examples:

- (a) there is a clear tension between the 'legitimate business interests of the owner or operator of the service' (s 138(2)(b) QCA Act) and 'the interests of persons who may seek access to the service' (s 138(2)(e) QCA Act); and
- (b) section 138(2)(f) QCA Act refers to 'the effect of excluding existing assets for pricing purposes' when any such exclusion is likely to have some tension with providing 'a return on investment commensurate with the regulatory and commercial risks involved' (pricing principle in s 168A(a), to be had regard to under section 138(2)(g) QCA Act).

That, of itself, makes it clear that it is possible for the QCA to determine the appropriate position for the draft access undertaking as being one that is not consistent with (or to use QR's language, which 'offends') a particular section 138(2) factor, including the section 168A pricing principles.

If the QCA was to determine the appropriate position as one which is not consistent with or offends the pricing principle in section 168A(a), that does not invalidate the QCA's decision, provided it has considered the pricing principle and then has nevertheless determined that despite being inconsistent with that pricing principles it remains the appropriate position. To be invalid the QCA would have had to have failed to consider the pricing principle in reaching its decision on appropriateness, which would then open the QCA's decision to challenge under the *Judicial Review Act 1991* (Qld) on the basis of a failure to take account of a relevant consideration.

If any stakeholder (including QR) considers that the pricing principle in section 168A(a) should have been given more weight in determining the appropriate decision on the draft access undertaking that is an issue that goes to the merits of the QCA's decision. The QCA's decision cannot be challenged under the *Judicial Review Act 1991* (Qld) on that basis unless the decision is so unreasonable no reasonable decision maker could have made that decision, which is an extremely high threshold. In other words, the courts are loathe to, and don't have power to, second-guess the QCA's exercise of its wide discretion regarding determining the appropriate position.

4 Reference to commonly accepted standards consistent with regulatory precedent

There is nothing in the QCA Act which requires the QCA to accept or follow 'commonly accepted standards' or 'regulatory precedent' in its decision making.

Of course, the QCA is highly likely to have regard to those matters under section 138(2) QCA Act (and is clearly entitled to do so under section 138(2)(h) QCA Act).

However, a slavish adherence to regulatory precedent (such that it was followed irrespective of the merits of the case) would potentially open the QCA's decision to risk of a successful judicial review challenge.

Consistent with that, it would clearly be open to the QCA to determine that, based on the merits of the draft access undertaking before it, that it was not appropriate for regulatory precedent to be followed. Where, for example, the QCA had considered regulatory precedent, but determined it was not appropriate to follow it in relation to the relevant part of the QR access undertaking on the basis that the circumstances or characteristics of QR or the West Moreton system justified a different treatment, that would be a perfectly legitimate exercise of the QCA's discretion.

5 Conclusions

We disagree with each of the assertions made by QR that are referred to in section 1 of this advice.

A more accurate summary of the QCA's relevant role and powers in considering a draft access undertaking would be:

- (a) The QCA is responsible for determining the appropriate position – and can only approve QR's draft access undertaking if it is either the same as the QCA's appropriate position or the only differences are 'minor and consequential amendments';
- (b) In formulating its views on what the appropriate position is, the QCA must have regard to each of the factors specified in section 138(2) of the QCA Act (which includes the pricing principles in section 168A as well and any factors the QCA considers relevant); and
- (c) Provided it has properly considered those factors, the QCA has a wide discretion as to how to balance the factors and come up with an appropriate position. There is no single factor which is to be given priority or which the appropriate position must be consistent with (or to put it another way, inconsistency with such a factor is not a grounds for invalidity of the QCA's decision on appropriateness provided that factor has been considered).

Yours sincerely


John Hedge
Managing Associate
Allens
John.Hedge@allens.com.au
T +61 7 3334 3171


Ben Zillmann
Partner
Allens
Ben.Zillmann@allens.com.au
T +61 7 3334 3538

Annexure B – Previous NHC submissions

18 July 2014

Mr Stephen Wisenthal
Queensland Competition Authority
Level 27
145 Ann Street
BRISBANE Q 4000

Email: rail@qca.org.au
stephen.wisenthal@qca.org.au
ravi.prasad@qca.org.au

Dear Stephen,

**QUEENSLAND RAIL'S WESTERN SYSTEM COAL TARIFFS
NEW HOPE CORPORATION SUBMISSION**

New Hope Group (NHG) appreciates the Queensland Competition Authority's substantial effort and rigour in considering the Western System tariff, and welcomes the opportunity to make a further submission to the Authority in response to its June 2014 Consultation Paper.

A comparison of Western System rail costs against other Australian coal rail systems demonstrates that Western System rail costs are uncompetitive (see Table 7 on page 45 of the June 2014 QCA Consultation Paper). The access tariff paid to Queensland Rail (QR), even without the additional impost of the tariff increase proposed by QR for the next regulatory period, threatens the commercial viability of NHG's existing activities relying on the Western System, and may prevent additional planned activities from passing the Group's investment hurdle. A reduction in the tariff is required to encourage long-term coal volume growth and to avoid stranding of the System's assets. In confidential Appendix 1 to this submission NHG provides financial data to substantiate these claims.

In 2006 the Western System tariff was set at \$10.50\$/'000 gtk, a level undoubtedly influenced by low volumes. This tariff level made it the most expensive coal rail corridor in the country. Access holders could not have envisaged that QR would, in the space of only 7 years, propose a 125% tariff increase, especially in light of the significant increase in volumes on the system during that period, which would ordinarily result in lower tariffs.

In Appendix 2, using a single point tariff calculation which understates revenue, NHG estimates Western System coal access revenues in the financial year ending June 2007, CPI adjusted to the year ending June 2012 were approximately \$20 million. Taking into account volume growth, and using the 2012-13 tariff, NHG estimates year ending June 2013 coal access revenue to be around \$61 million – a threefold increase.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriah@newhopegroup.com.au

DOCUMENT INFO

Page 1 of 22
A593287

NHG is very supportive of the QCA's desire to establish a repeatable and transparent methodology for deriving the Western System tariff. This is required to allow access seekers to make informed investment decisions, to forecast costs and to quantify long term pricing risk.

This submission responds to the ten questions raised by the Authority in the order presented in the consultation paper, and also raises a number of other relevant issues under the heading "other issues".

Question:

- 1. Do you agree with the QCA's estimate that the effect of the metropolitan blackout is a reduction of 22% of possible western system train paths? If not, please provide supporting evidence with reference to the analysis in Appendix 3 of B&H's report.***

Response:

NHG acknowledges that the B&H report provides a sound methodology for the future assessment of peak period impacts on coal service capacity. However, NHG believes that the B&H analysis is likely to understate the full impact of suburban restrictions. More transparency from QR would clarify the true impact of non-revenue passenger services outside of the period 0700 to 0930, and 1500 to 1830 travelling to and from stabling, particularly on the Cleveland Line. In addition the impact of train planners and controllers' behaviour as they strive for on-time passenger services extends well beyond the peak period. NHG suggests the B&H methodology could be refined by considering a wider time band, and with access to further data from QR.

Accurate network closure data (dates, durations, nature of restrictions) on the Western System, Ipswich Line, Corinda to Yeerongpilly, Yeerongpilly to Park Road, through to Lytton Junction and the Fisherman Islands would assist in establishing network closure facts. Like passing through Swiss cheese, all the paths through each part of the network need to be open. The published network closure times understate the full impact on coal train services. Restarting coal train services after closures takes time before steady state is achieved which results in additional lost paths.

The above factors imply that the effect of the blackout in reducing train-path availability is somewhat larger than the QCA's current estimate.

NHG requests that QR be required to provide information on the number of coal trains operated during the blackout periods, and broader shoulder peak periods as well as the combined impact of potentially uncoordinated maintenance possessions. This information will enable the B&H methodology to be further enhanced to take full account of impacts in future regulatory periods.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 2 of 22
A593287

Question:

2. ***Do you agree with the QCA's proposed approach to use contracted train paths in determining the volume estimate? If not, why not, and please provide supporting evidence.***

Response:

The question of whether tariff calculations should be based on contracted train paths or another basis such as system capacity is difficult in the context of the Western System.

Using contracted train paths is consistent with past practice, however, NHG has concerns with the use of contracted train paths in the future. NHG's concerns relate to (i) actual capacity exceeding capacity (in terms of paths) that QR is willing to contract and (ii) the dysfunctional consequences should demand for coal paths reduce due to volume reductions. These concerns are detailed below:

(i) System capacity and demand exceeds the capacity which QR is willing to contract

The level of paths which is contracted is artificially constrained (below true system capacity) by Government (QR's shareholder). NHG has been seeking to contract additional train paths for the past three years and has been unable to do so because of this constraint. This, when combined with the use of contracted train paths in developing tariffs, has a number of implications, including:

- QR can readily capture additional returns by making capacity available on an ad-hoc basis. Customers will pay the full cost of the true capacity when railings at the contracted path usage, then will overpay for this same capacity if this tariff is applied to path usages in excess of contract. NHG has previously submitted that QR should earn a reduced tariff for path usages in excess of contract, based on QR's variable costs plus a nominal additional payment to provide an incentive.
- From the producers' perspective, paths in excess of contract have a lesser value than contracted paths, because their availability is uncertain and therefore these paths cannot be relied upon for investment decisions.
- Payment of the full tariff for additional paths provides an incentive for QR to limit the contracting of these paths, as QR's revenue will be maximised by withholding these paths from contracts and offering the paths on an ad-hoc basis.
- To the extent that capacity is withheld due to a Government requirement, which we understand is motivated by the potential future needs of passenger services, the cost of this uncontracted capacity should be allocated to 'non-coal' users when developing the notional coal asset base, rather than simply allocating the RAB between coal and non-coal on the basis of contracted paths.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 3 of 22
A593287

(ii) A reduction in contracted paths should not flow through to higher tariffs

Using contracted paths in determining tariffs may suggest that tariffs will increase further in the event that contracted paths are relinquished or are not renewed on expiry. Given the high and uncompetitive existing (and proposed) tariff levels, such an increase would not be sustainable.

The above concerns could be addressed by:

- Adopting system capacity as the forecast, **OR**
- Adopting contracted train paths as the forecast **but:**
 - Developing a lower 'tier 2' tariff for train paths in excess of contract **AND**
 - If the 'allocated DORC' approach is used, allocating the cost of capacity which is not available for contracting to 'non-coal' **AND**
 - Ensuring that, in the event of any reduction in contracted paths, a full review of the derivation of tariffs is undertaken.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 4 of 22
A593287

Question:

3. What is the appropriate asset valuation methodology for the western system? Please provide supporting evidence.

Response:

The QCA has discussed two possible approaches to asset valuation for the Western System, being an 'asset allocation' approach based on a DORC methodology, and a historic cost approach. NHG's understanding is that the historic cost approach involves coal paths paying the full cost of new investment which was triggered by demand for coal paths post 1995, and no return or depreciation for existing (pre-1995) assets, while the DORC approach treats all users as sharing in the system (regardless of the history of investment in the system), and allocates shares of the DORC of this system to coal/non-coal traffic. NHG considers that the historic cost approach is the most appropriate for the following reasons:

(i) Application of DORC methodology is too subjective in the case of Western System assets.

A DORC approach is feasible when the asset resembles a modern engineering equivalent and when allocation of the asset between customers can be undertaken on a reasonable basis. In the case of the Western System, the task involves such a level of subjectivity that the key driver of the resulting tariff becomes the subjective decisions themselves, more so that the original DORC valuation. Examples of the subjective judgements required when applying DORC in the Western System include:

- How should the asset value be optimised to reflect the condition of the asset and the effects of this condition on future maintenance and capex requirements?
- How should the asset value be optimised to reflect the fact that the asset is not a 'modern engineering equivalent' and therefore cannot provide a service level which is competitive with other systems? Adjustments required in this area need to reflect:
 - Impacts of low axle load and train length on above rail costs.
 - Impacts of blackout periods on above rail costs.
 - Impacts of capacity limitations on above and below rail costs.
- How should the asset value be allocated between coal and non-coal traffic? Issues include:
 - Assessment of the full impact of blackout/restriction periods.
 - Treatment of the cost of capacity which is not contracted due to Government requirements (i.e. capacity which is effectively being reserved for future passenger services).

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 5 of 22
A593287

The Metropolitan system provides a demonstration of this issue. Developing a DORC in this system would involve subjective judgements and allocation debates of such complexity that all parties involved, through successive undertakings, have accepted that a more practical alternative must be applied. As a result, tariffs in this part of the system are not based on a DORC assessment of the Metropolitan system. NHG considers that the same concerns should lead to adoption of an alternative, practical, approach for the Western System. The historic cost approach provides such an alternative that is both transparent and repeatable.

(ii) Tariffs arising from the DORC approach are unsustainable.

The uncompetitive and unsustainable level of a tariff based on the DORC approach has been demonstrated in numerous submissions of NHG and other parties. NHG considers that tariffs based on a DORC will lead to lower utilisation of the network and ultimately to lower revenue for QR. The recent closure of one of the three mines using the system demonstrates that the concern is genuine.

(iii) Historic cost approach provides full return on existing and future investment in coal paths.

Under the historic cost approach, all investment triggered by demand for coal paths is recovered from coal traffic. This ensures that QR can continue to invest in the network and earn an appropriate return on investments. An allocation approach in which a portion of post-1995 investment is deemed to be recovered from non-coal traffic (i.e. DORC) will:

- Fail to provide QR with an appropriate return on post-1995 investments.
- Provide a strong disincentive for further investment in the network.

(iv) Historic cost approach best achieves criteria under QCA Act as set in the table below:

Criteria	Historical Cost	Allocated DORC
Promote economically efficient operation of, use of, and investment in...infrastructure.	Achieves criteria	<p>Fails:</p> <ul style="list-style-type: none"> • Higher tariff will promote stranding of the asset rather than efficient use of the asset. • Allocation of a share of future capex to non-coal traffic will prevent future investment in infrastructure.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email: awright@newhopegroup.com.au

DOCUMENT INFO

Page 6 of 22
A593287

<p>Legitimate business interests of owner or operator</p>	<p>Achieves criteria.</p> <p>Full return is received on post-1995 investment. Pre-1995 investment was based on non-coal traffic and QR's revenue from non-coal traffic is not adversely impacted by the entry of coal traffic. In fact, as noted by the QCA, (5.2 of consultation paper) <i>"without coal services, the pre-1995 network would generate revenues below its operating cost, and would be unlikely to cover even the lower capital spending that would have been required for QR to keep the track safe and operable"</i>. The value of pre-1995 assets, in the absence of coal traffic, would be scrap value or, as a going concern, substantively negative.</p>	<p>Fails:</p> <ul style="list-style-type: none"> QR will not receive appropriate return on post-1995 investments.
<p>Public interest</p>	<p>Achieves criteria.</p> <p>Promotes continuation of existing mining operations and encourages growth of the industry.</p>	<p>Fails:</p> <ul style="list-style-type: none"> Likely loss of employment and royalties. Reduced competition in coal markets. Likely loss of revenue for Government (as QR shareholder) as higher tariffs drive reduced utilisation and risk stranding.
<p>Interests of Access Seekers</p>	<p>Achieves criteria</p>	<p>Fails:</p> <ul style="list-style-type: none"> Severe impact on competitiveness of mining operations and possible (further) mine closures. Loss of business for above rail operator.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email: awright@newhopegroup.com.au

DOCUMENT INFO

Page 7 of 22
A593287

Effect of excluding existing assets for pricing purposes	Effect of exclusion of pre-1995 assets is reasonable due to nature and value of these assets. Recovery of value from these assets is excluded from coal traffics, but continues from non-coal traffic.	Inclusion of pre-1995 assets risks stranding assets and may ultimately reduce QR revenue.
Pricing principles	<p>Achieves criteria:</p> <ul style="list-style-type: none"> • Ongoing QR costs are recovered (opex, sustaining capex, maintenance) • Full return on post-1995 investment is received • QR may seek return on the (negligible) written down value of pre 1995 assets from non-coal users. 	<p>Fails:</p> <ul style="list-style-type: none"> • Allocation of a portion of post-1995 and future capex to non-coal will not provide an appropriate return on this investment.

Finally, NHG submits that the extreme difficulties and subjectivity involved in applying the allocated DORC approach is a relevant issue. NHG suggests that, as for the Metropolitan System, a simple and transparent alternative must be found. Historic cost is simple, transparent, easily rolled forward to future periods, and best meets each of the criteria of the QCA Act.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email: awriah@newhopegroup.com.au

DOCUMENT INFO

Page 8 of 22
A593287

Question:

4. ***Are B&H's asset valuation and related asset lives appropriate? If not, why not?***

Response:

NHG considers B&H's asset life assumptions to be reasonable on the basis the Western System coal mines are a going concern. NHG is not in favour of a DORC valuation for the Western System, because it is such an extreme outlier in terms of service attributes and capacity limitations, and the assets are not equivalent to a modern engineering standard.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 9 of 22
A593287

Question:

5. ***Is the QCA's proposed approach to maintenance costs for the western system appropriate? Stakeholders are requested to have regard to the B&H report.***

Response:

NHG is of the opinion that the analysis undertaken by B&H has sufficient rigour and professionalism to be relied upon by the QCA. Although of the opinion that further efficiencies can be gained through work practices and alternative possession planning, NHG accepts the QCA proposals on apportioning maintenance costs on a gross tonne kilometre basis, and reducing the resleepering costs by \$10m.

NHG interprets B&H's assessment (as set out on page 25 of the QCA Consultation Paper) as indicating that maintenance costs incurred to fit the Western System for its heavy-haul purpose should be treated as CAPEX (to be recouped over future periods) rather than as currently expensed OPEX. QR's long term capital and maintenance plans should be made available to customers and the QCA. These plans would provide much greater transparency and insight of QR's strategy. Regular and transparent reporting of actual expenditure would also assist in building confidence in QR's asset plans.

NHG requests that the QCA require QR to provide long term capital and maintenance plans for the Western System, and be required to report regularly on expenditure and progress.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 10 of 22
A593287

Question:

6. *Is the proposed approach to operating costs for the western system appropriate? Stakeholders are particularly invited to comment on the QCA's proposed estimate of train control costs.*

Response:

Although of the opinion operating costs could and should be lower, NHG supports the QCA's proposed approach to operating costs for the Western System and in particular the assessment by B&H that train control costs should be reduced to \$2m.

NHG would like to reiterate that the "glide path" concept introduced by QR is not acceptable. It sees no justification for Western System users to contribute to the costs of redressing QR's inefficiencies, especially if these are consequences of the government's privatization process. Hence, NHG strongly supports the QCA's position to reject QR's glide-path proposal (see page 29 of the Consultation Paper), noting that the proposal should be rejected whether or not QR has an appropriate business plan to deal with the inefficiencies.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriht@newhopegroup.com.au

DOCUMENT INFO

Page 11 of 22
A593287

Question:

7. ***What is the appropriate approach for determining the regulatory asset base for western system coal tariffs in the context of the QCA's approval criteria in s.138(2) of the QCA Act? Stakeholder comments are sought on the QCA's proposed options – the asset allocation approach and the historic cost approach.***

Response:

For the reasons discussed as part of NHG's answer to QCA's question number 3 of this submission, NHG considers that determining an asset valuation for the Western System based on an allocation of a DORC does not meet the approval criteria under s138(2) of the QCA Act. In contrast, the historic cost approach achieves all of the criteria.

NHG has previously sought advice from Gilbert and Tobin lawyers on a range of matters including:

- The flexibility of the QCA to consider a range of asset valuation approaches.
- The basis on which the choice of approach ought to be made.
- The relevance, in reaching a decision regarding asset valuation, of impacts which a particular tariff may have on the sustainability and competitiveness of mining operations.
- Regulatory precedents in which alternative asset valuation approaches have been adopted, and in which the impacts of tariffs on customers has been a relevant consideration.

We have attached the advice at Appendix 3. While we appreciate that the QCA will be well aware of all of the matters set out in the advice, we provide it as part of this public submission for the benefit of other stakeholders.

The key points of the advice are:

- The QCA is not constrained under the statutory framework to adopt or accept a DORC valuation. There is no requirement under the QCA Act to use any particular valuation methodology, and in G&T's view, there are a range of methodologies potentially open to the QCA.
- Depending on the circumstances, a reasonable balancing of the factors set out in the QCA Act may properly support the adoption of a different methodology, or combination of methodologies.
- If the adoption of one methodology is likely to have adverse impacts on upstream or downstream investment, this may suggest that, having regard to all of the relevant factors, an alternative methodology may be more appropriate.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email: awriah@newhopegroup.com.au

DOCUMENT INFO

Page 12 of 22
A593287

- In this case, a relevant consideration bearing on the choice of methodology would be the sustainability and competitiveness of access seekers' coal mining operations. If the effect of adopting a particular methodology would be to seriously damage the sustainability and international competitiveness of Western System users, this may suggest that a different methodology should be considered.
- There are numerous cases in which regulators have adopted methodologies other than pure DORC within the context of similar economic principles (including 'efficiency' tests). In several of these cases the regulator's decision on the asset value has explicitly taken into account the effects on pricing for customers, and values lower than DORC have been adopted in order to achieve acceptable price outcomes – the ACCC's 2011 decision in respect of Telstra, the original valuations of the Victorian electricity distribution networks, and the OffGAR's 2000 decision in respect of AlintaGas are all appropriate examples.

In summary, G&T's advice confirms the need to select a valuation methodology based on the statutory criteria, confirms the existence of regulatory precedents for adopting methodologies other than DORC, and confirms that the impacts which a particular approach may have on customers is a relevant consideration.

NHG's analysis (Question 3) suggests that an allocated DORC approach achieves few of the statutory criteria, and will achieve none of the criteria in the event that the resulting high tariffs cause further mine closures. In contrast, the historic cost approach meets all of the criteria.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 13 of 22
A593287

Question:

8. *Is there a way to address stakeholder concerns about high tariff levels while recognising the interests of Queensland Rail in receiving adequate revenue?*

Response:

NHG recognises that the pricing principles in the QCA Act require the QCA to provide QR with tariffs that allow it to earn revenue sufficient to recover its full efficient costs, including a risk-appropriate return on the efficient coal specific assets funded by QR since 1995. We consider that the historic cost approach best delivers this outcome.

NHG believes that unless the pricing mechanism encourages volume growth and the achievement of economies of scale, there is a significant danger that a downward spiral could develop with attempts to recover costs via high tariffs, discouraging volumes and leading to even higher prices and the eventual stranding of the Western System assets.

NHG is of the opinion that, subject to the necessary mining approvals, competitive rail tariffs (above and below rail) may lead to a minimum of 20mtpa of coal utilising the Western System.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 14 of 22
A593287

Question:

9. *Is extending the western system tariff across the metropolitan system reasonable?*

Response:

NHG appreciates the QCA's consideration of this issue. NHG has two concerns, one relating to how the metropolitan tariff is derived and the other relating to the potential for the Western System to be acquired by ARTC.

(i) Tariff Derivation

Concerning how the tariff is derived, NHG supports the view of the QCA on page 38 of the Consultation Paper: *"The QCA does not accept Queensland Rail's assertion that there will be a consistent split in future capital investment between...east and west of Rosewood."* NHG also accepts the QCA view *"that there needs to be an explicit mechanism for Queensland Rail to recover coal and freight-specific investment in the metropolitan network in order to create the right investment incentives. Simply extending the tariff between Columboola and Rosewood across the metropolitan system does not provide for this"* (p38, Consultation Paper).

NHG accepts that maintenance and operating cost allocations for the suburban system will be somewhat subjective given that:

- Coal and freight services are incremental users of a system designed primarily for passenger trains;
- Passenger trains receive higher standard below rail services in terms of infrastructure quality and priority for paths during passenger train operating hours; and
- QR's assessment of capacity to pay for various traffics does not seem to be consistent, with higher value grain and minerals being charged less per thousand gross kilometre than coal of lower value.

Consequently, NHG proposes a slight variation to the QCA's proposed approach in order to address the separate investment requirements of the Suburban and Western systems. Understanding the difficulties of determining appropriate share of maintenance and operating costs across the metropolitan system, NHG proposes that the maintenance and operating costs west of Rosewood should be extended across the metropolitan system.

A similar extension approach to investment is however **totally inappropriate** because:

- There is unlikely to be a "consistent split in future capital investment between...east and west of Rosewood"; and
- "There needs to be an explicit mechanism for Queensland Rail to recover coal and freight-specific investment in the metropolitan network in order to create the right investment incentive".

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriacht@newhopegroup.com.au

DOCUMENT INFO

Page 15 of 22
A593287

Consequently, NHG proposes that capital costs (coal specific post 1995 and genuine future coal required expenditure within the suburban system) should be used to determine the return on assets and depreciation components of the suburban system access tariff.

The new metropolitan tariff would then reflect the combination of:

- operating and maintenance costs based on the extension of the Western System tariff; plus
- coal-specific post 1995 metropolitan coal asset return and depreciation.

This combined tariff would ensure that coal services pay the full incremental capital cost and also make a contribution to fixed costs (well in excess of their incremental maintenance and operating costs).

This will also ensure that Queensland Rail is provided the right incentives for future investment. NHG is comfortable that the QCA is in a position to ensure that only investments which are appropriately categorised as coal requirements investments are included in the metropolitan tariff.

(ii) Potential ARTC Acquisition

In the event of the transfer of the Western System to ARTC, the Western System tariff to Rosewood levied by ARTC and the metropolitan tariff levied by QR should not exceed the tariff determined for this regulatory period which would otherwise apply where the network was not divided up. NHG has expanded on this concern and the proposed solution under the heading of "Other Issues".

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriacht@newhopegroup.com.au

DOCUMENT INFO

Page 16 of 22
A593287

Question:

- 10. Is it reasonable to have a separate asset base for coal and freight-specific investment in the metropolitan system? Please explain and justify any alternative approaches.**

Response:

As noted in our response to Question 9, NHG supports a separate asset base for coal specific assets genuinely required to support coal services. Where assets are required for additional coal services, NHG supports their incorporation into a metropolitan coal asset base. This support acknowledges that the QCA has a rigorous investment approval process to ensure that the investment is required for coal, and the cost of the asset has been optimised.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriqht@newhopegroup.com.au

DOCUMENT INFO

Page 17 of 22
A593287

Other Issues:

Potential acquisition of the Western System by the ARTC:

NHG notes that since the current regulatory period commenced the ARTC has been invited to conduct due diligence on the regional assets of QR Ltd, including the Western System assets to the west of Rosewood. For the remainder of the track east of Rosewood (i.e., Rosewood to Port of Brisbane) it is expected that QR will retain ownership and control.

As noted in the response to Question 9 above, NHG is concerned that existing users are not disadvantaged by such a transaction which could result in two independently set access tariffs adding to exceed the final decision on Western System tariffs for the current regulatory period.

One way the QCA can assist in providing certainty to users, QR and ARTC is by separating the Western System and Suburban System Tariffs now. This is consistent with our approach to determining how the Metropolitan Tariff should be determined.

Payload Variation

During the regulatory period it is highly likely that alternative train configurations will be allowed, or new rolling stock introduced that will increase train payload. These changes could result in fewer train paths being required to shift the same level of tonnage, increasing the capacity of the Western System. The existing two part tariff allows the benefits of efficiencies to be shared, however, if an access holder wishes to relinquish already held paths as a result of efficiency gains, there is currently a relinquishment fee, which is payable if there is any difference in QR's net revenue. This approach fails to ascribe any value to the opportunity to seek further users of the additional capacity and may lead to the regrettable situation where efficiencies are not pursued because a collier will receive no economic benefit. NHG requests that the QCA seek to ensure that the tariff-setting mechanism and the relinquishment arrangements do not discourage the adoption of such system efficiencies.

WACC

NHG notes the QCA's discussion of QR's WACC in Section 3.4 of the Consultation Paper. It notes that the QCA is conducting a wider investigation into WACC settings for its regulated entities, focusing especially on Aurizon and QR, and that the Consultation Paper does not seek specific feedback on the topic from Western System stakeholders.

NHG is concerned to ensure that QR's Western System WACC does not over-compensate QR for the risks it bears. NHG also requests that the QCA make a determination on QR's WACC as early as is practical and that it ensures that the basis for the determination is transparent and repeatable. Uncertainties about key determinants of QR's access tariffs are problematic for access holder's business planning, including investment decision making processes.

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriht@newhopegroup.com.au

DOCUMENT INFO

Page 18 of 22
A593287

Conclusion

NHG contends that DORC is not an appropriate methodology when considering an "outlier" corridor such as the Western System which has limited scale economies, standards far from modern engineering equivalents, and significant above rail cost impositions due to those standards restricting both train length and axle load. While a holistic approach to optimisation, accounting explicitly for above rail impacts, may, in theory, deliver a realistic starting point for a regulated asset base, the subjective judgements required to implement this approach are so complex and material that they call into question the relevance of the starting point. An alternative approach is required. NHG supports the alternative 'historic cost' proposal which provides a simple, transparent and less subjective approach to determining the coal asset base. This approach achieves all of the statutory criteria, while the allocated DORC approach fails to meet the criteria and may ultimately result in the stranding of the assets of both QR and the coal miners.

NHG also suggests that QR should be required to provide long term asset management strategies including capital and maintenance expenditure to provide greater certainty and transparency for coal producers. In addition, regular reporting on expenditure and progress of works would inspire greater confidence.

NHG also supports the QCA's suggestion that the western system tariff be split into two separate 'stand-alone' tariffs, i.e. a metropolitan tariff and a western tariff. The objective is to reduce the risks associated with possible change of ownership of parts of the network leading to a higher combined tariff in future, to ensure that the cost of capex incurred in the Western System is not over-recovered, and to eliminate the disincentive to invest, for coal services, in the metropolitan system.

NHG recognises that QR's access tariffs should allow it to recover full efficient costs, including an appropriate return on capital invested in the provision of coal services. The historic cost approach achieves this, while ensuring that the cost recovery process does not jeopardise the commercial viability of users' existing operations or their expansion plans. The historic roll-forward approach delivers a tariff significantly lower than the current tariff, but one that is still comparatively high. It does begin to address the key issue that is inhibiting system volume growth and threatening asset stranding.

Yours faithfully,
NEW HOPE CORPORATION LIMITED

Shane Stephan
Chief Executive Officer

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awriht@newhopegroup.com.au

DOCUMENT INFO

Page 19 of 22
A593287

APPENDIX 2:

Railed tonnages 2006-2007

Origin	Tonnes x 1,000	Tariff /1000 gtk	#Tariff/tonne	#Approximate Revenue
Western System	3,615	\$10.50	\$4.50	\$16,267,500
Ebenezer	610			
Total System	4,225			\$16,267,500

*CPI adjusted to Jul 2012 \$19,579,798

Railed tonnages 2012-2013

Origin	Tonnes x 1,000	** Tariff /1000 gtk	#Tariff/tonne	#Approximate Revenue
Western System	7,320	\$18.22	\$8.40	\$61,488,000
Ebenezer	1,260			
Total System	8,580			\$61,488,000

% increase Western System 74% 87% 278%

Western System revenue is understated as this figure assumes all railings from a single point

Railed tonnages 2006-2007 derived from Port of Brisbane trade figures using the same logic as per QCA discussion paper table 1 page 8

Railed tonnages 2012-13 sourced from QCA discussion paper Table 1 page 8

* CPI data taken from Appendix 3, Quarter ending Sept 2006 = 83, Quarter ending Sept 2012 = 99.9

** estimate

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
 A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
 T: +61 7 3418 0500 F: +61 7 3418 0355 W: newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
 Mobile: 0409 149 652
 Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 21 of 22
 A593287

APPENDIX 3: Gilbert and Tobin Advice

REGISTERED OFFICE

P: PO Box 47, Ipswich, QLD Australia 4305
A: 3/22 Magnolia Drive, Brookwater, QLD Australia 4300
T: +61 7 3418 0500 **F:** +61 7 3418 0355 **W:** newhopegroup.com.au

CONTACT DETAILS

Phone: +61 7 34180 506
Mobile: 0409 149 652
Email:
awright@newhopegroup.com.au

DOCUMENT INFO

Page 22 of 22
A593287

Memorandum of advice

Confidential and privileged



L A W Y E R S

Melbourne

101 Collins Street Melbourne VIC 3000
Australia
GPO Box 90 Melbourne VIC 3001
T +61 3 8656 3300 F +61 3 8656 3400
www.gtlaw.com.au

22 April 2014

To New Hope Group
From Simon Muys / Geoff Petersen
Subject Queensland Rail proposal re Western System assets -
asset valuation methodologies under the QCA Act

1 Overview

1.1 Background

New Hope Group (**New Hope**) has sought advice in relation to asset valuation methodologies which may be adopted by the Queensland Competition Authority (**QCA**) for Queensland Rail's Western System assets.

Queensland Rail has advocated a depreciated optimised replacement cost (**DORC**) methodology for valuing its Western System assets, for the purposes of determining reference tariffs submitted as part of its June 2013 draft access undertaking (**June 2013 DAU**). Queensland Rail has argued that this methodology is at least preferable having regard to the statutory criteria.

New Hope has sought advice on whether there is any requirement to use a DORC valuation methodology under the access to services framework in Part 5 of the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**), and if not, what other methodologies may be available to an access provider and/or the Queensland Competition Authority.

New Hope has also asked whether, in determining an appropriate asset valuation and reference tariff for Queensland Rail's Western System assets, the sustainability and competitiveness of access seekers' coal mining operations may be a relevant consideration.

1.2 Summary of advice

The QCA is not constrained under the statutory framework to adopt or accept a DORC valuation. There is no requirement under the QCA Act to use any particular valuation methodology, and in our view, there are a range of methodologies potentially open to the QCA.

Depending on the circumstances, a reasonable balancing of the factors set out in the QCA Act may properly support the adoption of a different methodology, or combination of methodologies. For example, if the adoption of one methodology is likely to have adverse impacts on upstream or downstream investment (particularly for access seekers and others with long-lived and sunk assets) this may suggest that, having regard to all of the relevant factors, an alternative methodology may be more appropriate.

In this case, a relevant consideration bearing on the choice of methodology would be the sustainability and competitiveness of access seekers' coal mining operations. If the effect of adopting a particular methodology would be to seriously damage the sustainability and international competitiveness of Western System users, this may suggest that a different methodology should be considered.

Our conclusions are based on the following:

- our interpretation of the relevant legislative provisions governing the QCA's decision-making, particularly the object of Part 5 of the QCA Act, and the pricing principles;
- the relevant background to these legislative provisions, including statements made by the Productivity Commission (PC) when it recommended the incorporation of similar provisions in the national access regime; and
- our review of previous regulatory decisions and judicial authority on asset valuation methodologies which may be adopted under these (or similar) criteria.

The QCA Act requires the QCA to have regard to a range of factors in assessing a draft access undertaking. These include (but are not limited to), the object of Part 5, the pricing principles (in s.168A), the interests of both the service provider and access seekers, and any other issues which the QCA considers relevant. The list of relevant factors is broad, and different factors may at times point in a different direction, in terms of the most appropriate choice of valuation methodology.

It may be that, depending on circumstances, a proper balancing of the statutory criteria favours a different methodology over DORC, such as an historic cost methodology. For example, if the relevant assets were constructed relatively recently and good historical cost records are available, the advantages of simplicity and transparency inherent in an historical cost approach may outweigh any perceived advantages of DORC. Alternatively, if adoption of a DORC methodology would produce undesirable price outcomes for network users (e.g. prices that are likely to distort usage and complimentary investment decisions), then this may suggest DORC is also not appropriate.

The language of the object and pricing principles themselves (which are common to many Australian regulatory frameworks) does not indicate a requirement to use any particular valuation methodology, nor does it prohibit the use of any methodology. The pricing principles provide high level guidance on the pricing conditions which will satisfy the objectives, but do not prescribe any methodology for determining the cost base.

While there is a reference to the recovery of "efficient costs" in the first of the pricing principles in s.168A, we do not share the apparent view of Queensland Rail that this necessitates or requires the adoption of a forward-looking asset valuation methodology such as DORC in all cases. It simply means that the service provider is only entitled to recover costs that are efficiently incurred, and will not be entitled to recover costs imprudently or inefficiently incurred.

Clearly if past investments were prudent and efficient, the service provider ought not to be prohibited from including the cost of those past investments in its capital base, and recovering those costs through access charges (i.e. an historic or actual cost valuation of the relevant assets would not necessarily be inconsistent with this outcome or the statutory pricing principles).

This interpretation is strongly supported by the relevant background materials. It is clear that the Productivity Commission (PC), which originally proposed pricing principles of the kind that now appear in the QCA Act, did not intend for those principles to restrict a regulator in terms of its choice of asset valuation methodology (or indeed its pricing methodology more generally). On the contrary, the PC intended that regulators consider valuation methodologies on a case-by-case basis.

Finally, we note that there are numerous cases in which regulators have adopted methodologies other than pure DORC within the context of similar economic principles (including 'efficiency' tests). In several of these cases the regulator's decision on the asset value has explicitly taken into account the effects on pricing for customers, and values lower than DORC have been adopted in order to achieve acceptable price outcomes – the ACCC's 2011 decision in respect of Telstra, the original valuations of the Victorian electricity distribution networks, and the OffGAR's 2000 decision in respect of AlintaGas are all examples of this.

We also note that another area in which regulators generally have some discretion, and where the impact of price outcomes on customers may be a relevant consideration, is in relation to the profile of capital cost recovery over time. There are several cases in which regulators have chosen to make adjustments to the capital cost recovery profile (or have accepted adjustments proposed by businesses), involving either deferral of depreciation or loss capitalisation. These adjustments have often been made in order to reduce tariffs for users in the short to medium term, and ensure efficient use of the relevant infrastructure.

2 Background

2.1 Available asset valuation methodologies

There are a number of valuation methodologies that are recognised as providing the basis for determining a regulatory asset base (RAB).¹ The types of valuation methodologies typically identified by regulatory authorities as being available are:²

- **Historic cost** – this is the original cost of acquiring the asset including the relevant financing costs during construction.
- **Replacement cost** – this is the current cost of replacing the asset with another asset that provides the same service potential. This need not be the same asset, but rather the asset that hypothetically is the best (least-cost) option under current technology.
- **Optimised deprival value (ODV)** – this is the cost to the asset owner if deprived of the asset. In practice ODV equals replacement cost, except where the asset would not be replaced (in which case ODV is the market value of the asset, as determined by the foregone net revenues for supplying its services).
- **Reproduction cost** – this is the cost of reproducing the existing plant in substantially the same form at current prices.
- **Scrap value** – this is the value of the asset in its next best alternative use.

Within each of these types of methodology, there are variations and methodological choices. This is particularly the case in relation to optimised replacement cost methodologies, as various assumptions need to be made about how an optimised asset would (hypothetically) be designed. For example, in determining replacement costs, it may be assumed that the design of an asset is *fully* optimised when it is replaced, or only *partially* optimised.³ Alternatively, it may be assumed that only the technology choice is optimised, and not the network design. These types of methodological choices which need to be made in applying a replacement cost methodology can in some cases be hotly disputed.⁴

¹ “Regulatory asset base” is the term most commonly used by Australian regulators to identify the set of assets used to supply a regulated service. In some cases other terms may be used, such as “regulatory asset value” (RAV) or “depreciated asset value” (DAV).

² The ACCC has considered various valuation methodologies in several formative publications, namely: ACCC, *Access pricing principles – telecommunications: a guide*, July 1997 at pp41-43; ACCC, *Draft Statement of Principles for the Regulation of Transmission Revenues*, May 1999, at pp39-42.

³ For example, in its *Draft Statement of Principles for the Regulation of Transmission Revenues* (May 1999) the ACCC noted in relation to optimisation as part of a DORC methodology: “Discretion is available in deciding how the optimal system configuration should be determined. Even in the absence of alternative technologies there is an issue as to what level of optimisation should be considered and whether it should be done in respect of each item of infrastructure or on a system-wide basis. There is clearly an important trade-off involved in the level of detail considered and the cost of conducting the evaluation.”

⁴ For example, when a replacement cost methodology was applied for the purposes of pricing Telstra’s fixed-line services, significant dispute arose as to the extent of optimisation that should be assumed. There were three possible approaches considered (existing network design, “scorched node” and “scorched earth”), along with variations to these approaches. The

Moreover, under any of these methodologies, there are various ways in which inflation and depreciation of the asset value over time may be treated. In some cases the asset value will be adjusted to account for inflation over time, while in other cases the asset value may be left in nominal terms, with inflation accounted for in some other way (e.g. through the application of a nominal rate of return). Accumulated depreciation may be accounted for in a variety of different ways, including through a simple application of straight-line depreciation, or alternatively by seeking to account for past capital returns.

It is generally recognised that each of these methodologies has strengths and weaknesses. Accordingly, the choice of methodology in any particular case will depend on the circumstances of that case, including the characteristics of the asset, the nature of demand, and any previous practice in relation to valuation of that asset.

In some cases, the valuation ultimately adopted may reflect a blending of two or more of the above methodologies, or an adjusted form of one methodology. Depending on the circumstances, it may be appropriate to adopt an adjusted or hybrid methodology instead of applying one methodology in its 'pure' form (some examples of this are set out in section 4 below). Thus, the set of methodologies set out above will in some cases only provide a starting point for the asset valuation exercise.

As noted by former ACCC Commissioner, Professor Stephen King, in an early paper on asset valuation and access:⁵

"The choice of an appropriate asset valuation technique will depend on both the questions being addressed and the nature of the relevant assets. There is neither a single valuation method that is appropriate for all circumstances, nor is there always an unambiguously preferred choice of valuation method for any specific situation."

Professor King's paper goes on to explain the strengths and weaknesses of various valuation methodologies, including historic cost, reproduction cost, replacement cost, deprival value and scrap value. He says that his analysis broadly supports the use of historic cost valuation, although he notes that there are various circumstances in which alternative methodologies may be preferable. Professor King concludes:⁶

"The analysis presented in this paper broadly supports the use of historic or original cost asset valuation for access purposes. The arguments in favour of historic cost are impressive. It is administratively simple and transparent. It involves less subjective assessment and guesswork and usually will provide adequate incentives for investment and equivalent operational incentives compared with alternative valuation procedures.

That said, the case for historic cost is not overwhelming. We have noted a variety of circumstances where alternative valuation procedures may provide better incentives for allocative, productive or investment efficiency. For example, scrap valuation is likely to lead to greater allocative efficiency for existing sunk assets compared to historic cost valuation. Generalised replacement cost valuation will provide improved productive incentives and standard replacement cost procedures may improve investment incentives under certain types of asymmetric information."

The ultimate conclusion of Professor King's paper, which is now reflected in the general practice of Australian regulators, is that asset valuation methodologies should be considered on a case-by-case basis.

ACCC sought to apply a "scorched node" approach, which involved taking existing network nodes as given, and optimising cable routes between those nodes. However there was significant dispute between the ACCC, Telstra and access seekers as to how this approach should be applied in practice to determine the optimised network design (and hence the optimised replacement cost valuation). Some of this dispute is summarised by the Australian Competition Tribunal in its review the ACCC's decision to reject Telstra's 2008 ULLS undertaking (*Application by Telstra* [2010] ACompT 1, [104]-[112]).

⁵ Stephen P. King, 'Asset Valuation and Access' (Discussion Paper No 365, Australian National University Centre for Economic Policy Research, April 1997), p 10.

⁶ Stephen P. King, 'Asset Valuation and Access' (Discussion Paper No 365, Australian National University Centre for Economic Policy Research, April 1997), p 19.

2.2 Queensland Rail's proposed approach to asset valuation

Queensland Rail has proposed to use a DORC valuation methodology for the purposes of determining reference tariffs for its western system coal services, submitted as part of its June 2013 DAU.

Queensland Rail argues that DORC has a number of advantages over other methodologies, such as depreciated actual cost (DAC), including:⁷

- the optimisation process ensures that obsolete, poorly sized or poorly located assets are not included in the capital base and consequently are not paid for by users;
- assets can be valued in a way that reflects current technology rather than outdated technology; and
- it establishes asset values that will minimise incentives for 'inefficient' by-pass of the network.

Queensland Rail also states that "DORC is the preferred valuation approach as evident in other regulatory jurisdictions", and that DAC would be unsuitable for valuing Queensland Rail's assets.⁸

The June 2013 DAU is currently being considered by the QCA under Part 5 of the QCA Act.

3 Legislative framework

3.1 Relevant objectives and principles under the QCA Act

The framework for assessment of draft access undertaking is set out in Part 5 of the QCA Act.

Relevantly, Part 5 of the QCA Act sets out the factors affecting approval of a draft access undertaking as follows:⁹

(2) The authority may approve a draft access undertaking only if it considers it appropriate to do so having regard to each of the following—

- (a) the object of this part;
- (b) the legitimate business interests of the owner or operator of the service;
- (c) if the owner and operator of the service are different entities—the legitimate business interests of the operator of the service are protected;
- (d) the public interest, including the public interest in having competition in markets (whether or not in Australia);
- (e) the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected;
- (f) the effect of excluding existing assets for pricing purposes;
- (g) the pricing principles mentioned in section 168A;
- (h) any other issues the authority considers relevant.

⁷ Queensland Rail, *AU1 West Moreton Reference Tariff Reset Overall Submission*, June 2013, pp 10-11.

⁸ Queensland Rail, *AU1 West Moreton Reference Tariff Reset Overall Submission*, June 2013, p 11.

⁹ *Queensland Competition Authority Act 1997* (Cth), s 138.

Many of the factors identified in section 138 of the QCA Act mirror those appearing in other Australian access regimes, including the general national access regime (Part IIIA of the Competition and Consumer Act 2010 (Cth) (CCA)) and the telecommunications access regime (Part XIC of the CCA). For example, the references to “*legitimate business interests*” and “*the interests of persons who may seek access*” both also appear in Part IIIA and Part XIC of the CCA.¹⁰

It is clear that these factors will not always point in the same direction, and hence some balancing may be required. In particular, some balancing between the legitimate business interests of the access provider, and the interests of access seekers, is likely to be required.

The object of Part 5 of the QCA Act (referred to in factor (a)) is as follows:¹¹

“The object of this part is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets.”

The pricing principles (referred to in factor (g)) are as follows:¹²

The pricing principles in relation to the price of access to a service are that the price should—

- (a) generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved; and
- (b) allow for multi-part pricing and price discrimination when it aids efficiency; and
- (c) not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent the cost of providing access to other operators is higher; and
- (d) provide incentives to reduce costs or otherwise improve productivity.

The objects clause and pricing principles also mirror the objectives and principles set out in other Australian third party access regimes.¹³ As will be discussed further below, objectives and principles of this nature were originally recommended by the Productivity Commission (PC) for the national access regime, and were subsequently integrated into other access regimes (including the QCA Act regime) pursuant to a COAG agreement.

Beyond the overall objective and high level pricing principles, there is no further guidance in Part 5 of the QCA Act in relation to methodologies to be adopted for pricing of access to services. There is no reference to particular methodologies to be used for asset valuation, or for any other aspect of price calculations.

3.2 Background to the object and pricing principles

The object of Part 5 of the QCA Act and the pricing principles were both inserted by the *Queensland Competition Authority Amendment Act 2008* (Qld). As noted in the second reading speech accompanying the amending bill, these changes to the QCA Act implemented certain commitments made by the State of Queensland in the 2006 COAG Competition and Infrastructure Reform Agreement (CIRA).¹⁴ The CIRA had included an agreement by COAG to streamline third party access regimes, and include in these regimes a consistent set of regulatory principles.¹⁵

¹⁰ CCA, ss 44ZZA(3), 152BCA(1).

¹¹ *Queensland Competition Authority Act 1997* (Cth), s 69E.

¹² *Queensland Competition Authority Act 1997* (Cth), s 168A.

¹³ For example: CCA, ss 44AA, 44ZZCA.

¹⁴ Queensland, *Parliamentary Debates*, Legislative Assembly, 13 February 2008, 151 (AP Fraser).

¹⁵ Council of Australian Governments, Competition and Infrastructure Reform Agreement, 10 February 2006, clause 2.4.

The objects clause and pricing principles which were agreed to in the CIRA, which now appear in the QCA Act, were originally formulated by the PC as part of its 2001 review of the national access regime. In its final report on the national access regime, the PC recommended the insertion of an objects clause and pricing principles in Part IIIA of the CCA. The PC saw a number of benefits in doing this, including:¹⁶

- an objects clause would reduce uncertainty by assisting all parties — regulators, the judiciary, access seekers, facility owners and potential infrastructure investors — to interpret the intent of various criteria;
- pricing principles would provide guidance on how the broad objectives of access regimes should be applied in setting more detailed terms and conditions; and
- pricing principles would provide a measure of certainty to regulated firms and access seekers.

The PC recommended that the objects clause be as follows:¹⁷

"The object of this Part is to:

- (a) promote economically efficient use of, and investment in, essential infrastructure services; and
- (b) provide a framework and guiding principles to discourage unwarranted divergence in industry-specific access regimes."

This wording was ultimately adopted in the objects clause for Part IIIA (s 44AA), with only relatively minor amendment. The wording of limb (a) was also adopted in the CIRA, again with only relatively minor amendment. The core of the PC's recommended objective — to promote economically efficient use of, and investment in, essential infrastructure — now appears as the central objective of third party access regimes around Australia, including the QCA Act regime.

The pricing principles recommended by the PC were as follows:¹⁸

(a) that regulated access prices should:

- (i) be set so as to generate expected revenue across a facility's regulated services that is at least sufficient to meet the efficient long-run costs of providing access to these services;
- (ii) include a return on investment commensurate with the regulatory and commercial risks involved;
- (iii) generate revenue from each service that at least covers the directly attributable or incremental costs of providing the service.

(b) that the access price structures should:

- (i) allow multi-part pricing and price discrimination when it aids efficiency;
- (ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.

(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

¹⁶ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, pp 126, 143.

¹⁷ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, p 134.

¹⁸ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, pp 338-339.

As can be seen, the principles recommended by the PC are very similar to those that were ultimately agreed to in the CIRA and adopted in the QCA Act. The only changes made in the CIRA were to combine limbs (a)(i) and (a)(ii), remove limb (a)(iii), and slightly amend the wording of limb (b)(ii).

In its final report, the PC explained its proposed pricing principles at some length, including how they were intended to be applied in practice. Most importantly, the PC emphasised that its pricing principles were not intended to mandate any particular methodology for determining access prices. Rather, the pricing principles were intended to provide high level guidance on the pricing conditions which will satisfy the objectives of the access regime.¹⁹ The PC explicitly noted that “a range of pricing methodologies will comply with these principles and will be suited to different circumstances”, and that “the approach taken to implementing any pricing principles depends on the instruments available to regulators and the way they can be applied”.²⁰

Specifically in relation to asset valuation, the PC noted various methods may be available to regulators, including DAC and DORC. The PC further noted that each of these methodologies may have strengths and weaknesses, and should therefore be assessed on a case-by-case basis. The PC noted that in many circumstances DAC will have advantages over DORC, particularly in terms of simplicity, transparency and objectivity.²¹

Importantly, the PC concluded that regulators should not be bound to any particular valuation approach. The PC stated:²²

“Clearly, the myriad of specific issues that arise across infrastructure sectors means that regulators should not be bound to use one particular asset valuation approach in all situations. Rather, the Commission considers that the approach used should have regard to specific circumstances.”

Thus, it is clear that the PC, which originally drafted the pricing principles that now appear in the QCA Act, did not intend for these principles to restrict a regulator in terms of its choice of asset valuation methodology (or indeed its pricing methodology more generally). On the contrary, the PC clearly intended that regulators consider valuation methodologies on a case-by-case basis. The pricing principles were intended to provide high level guidance only on the pricing conditions which will satisfy the objectives of the access regime.

3.3 Conclusions on the legislative framework

The QCA Act does not mandate any particular asset valuation methodology to be used in determine prices for access to services.

There is no reference any particular methodologies which are to be used, nor is there any prohibition on any method. If the QCA Act was intended to be prescriptive as to the asset valuation methodologies to be used for access pricing purposes, we would have expected this to have been explicit.

The legislative framework requires that, as with any aspect of a draft access undertaking, in considering a proposed asset valuation methodology the QCA have regard to the factors set out in section 138. Depending on the circumstances of a particular case, a balancing of these various factors may favour one methodology over another. However it seems unlikely that one methodology would be preferable in all cases, having regard to these factors.

The list of relevant factors is relatively broad, and will not always point in the same direction in terms of the appropriate choice of valuation methodology. It may be that in some cases DORC is seen as appropriate because historical cost records are poor, and the outcome of applying this method would provide an appropriate balance between the interests of the access provider and access seekers.

¹⁹ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, p 338.

²⁰ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, p 339.

²¹ Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, p 364.

²² Productivity Commission, *Review of the National Access Regime: Inquiry Report*, 28 September 2001, p 366.

However in other cases a proper balancing of the statutory criteria may favour a different methodology, such as an historic cost methodology. For example, if the relevant assets were constructed relatively recently and good historical cost records are available, the advantages of simplicity and transparency inherent in an historical cost approach may outweigh any perceived advantages of DORC. Alternatively, if adoption of a DORC methodology would produce undesirable price outcomes for network users (e.g. prices that are likely to distort usage and complimentary investment decisions), then this may suggest DORC is not appropriate.

The language of the object of Part 5 and the pricing principles (both relevant factors under section 138) does not indicate that the regulator is to be bound to any particular valuation methodology. The pricing principles simply provide high level guidance on the pricing conditions which will satisfy the objectives of Part 5 of the QCA Act – that is, in order to provide incentives for economically efficient operation of, use of and investment in, significant infrastructure, the service provider ought to be provided with an opportunity to recover at the least the efficient costs it incurs in providing access. However the pricing principles do not prescribe any methodology for determining the cost base.

In our view, the reference to recovery of “efficient costs” in the pricing principles does not imply that a forward-looking asset valuation methodology such as DORC will be required in all cases. It simply means that the service provider is only entitled to recover costs that are efficiently incurred, and will not necessarily be entitled to recover costs imprudently or inefficiently incurred. Clearly if past investments were prudent and efficient, the service provider should be entitled to recover the cost of those investments.

This interpretation is strongly supported by the relevant background materials. It is clear that the PC, which originally drafted the pricing principles that now appear in the QCA Act, did not intend for these principles to restrict a regulator in terms of its choice of asset valuation methodology (or indeed its pricing methodology more generally). On the contrary, the PC clearly intended that regulators consider valuation methodologies on a case-by-case basis.

4 Relevant precedent

4.1 Approach taken by Australian regulatory authorities to asset valuation

(a) Approach taken by the ACCC to valuation of Telstra's fixed-line assets (2011)

A recent example of a regulator taking into account various methodologies, and exercising judgement in its final choice of valuation, is the ACCC's 2011 decision in respect of Telstra's fixed-line assets.

As part of a transition from a TSLRIC+ methodology²³ to a building block model for pricing of Telstra's declared fixed-line services, the ACCC needed to establish an initial valuation for the fixed-line assets. In this context, the ACCC considered various methodologies, including DORC, DAC, and indexed (inflated) historic cost. The ACCC derived a DAC value of approximately \$13 billion, based on the depreciated value of Telstra's fixed-line assets, as recorded in its regulatory accounts. As an alternative to this DAC value, Telstra had submitted DORC and indexed historic cost values of \$32 billion and \$28 billion respectively.²⁴

In considering these alternative valuations, the ACCC noted that there is no uniquely 'correct' value for the initial RAB, and that an element of judgement is therefore required to determine an appropriate value. The ACCC noted that the key considerations in setting the RAB value include:

- the legitimate commercial interests of the access provider and access seekers;

²³ TSLRIC+ stands for total service long-run incremental cost, plus a contribution to common costs. The TSLRIC+ methodology was applied by the ACCC to determine prices for declared access services in the telecommunications sector until 2011. Since 2011, the ACCC has applied a building block methodology to determine prices for declared telecommunications services.

²⁴ ACCC, *Inquiry to make final access determinations for the declared fixed line services: Final Report*, July 2011, p 39.

- the level of past recovery on the assets received by the access provider;
- the incentives for efficient future investments in network assets;
- industry confidence in making future investment decisions; and
- the reliability of the valuation methodology.²⁵

In its final decision, the ACCC adopted a value between its DAC valuation and Telstra's DORC. The ACCC used its DAC value as a starting point, and made various upwards adjustments to this value, ultimately arriving at a valuation which allowed it to maintain price stability for one of the fixed-line services (the unconditioned local loop service, or ULLS), while allowing prices for other services to fall.²⁶ The valuation ultimately adopted by the ACCC (\$17.22 billion as at 1 July 2009) was closer to its DAC valuation than Telstra's DORC or indexed historic cost values.

The ACCC explained its reasoning as follows:²⁷

"The ACCC confirms its view that there is no uniquely 'correct' value for the RAB. Consequently, the ACCC considered a number of alternative valuation methodologies including DAC, DORC and current cost accounting in settling on an appropriate initial RAB value. The ACCC also considered the views and information submitted during the consultation process, the limitations of the historical records (particularly for long-lived assets), and price stability to the extent that it supports past investments and promotes industry confidence in making future investment decisions.

The ACCC has calculated a value within the suitable range of RAB values set by the DAC and DORC values for Telstra's network assets. In calculating an appropriate value within this range, the ACCC used the DAC value as a starting point because the more substantial limitations associated with estimating a DORC value meant that it was not considered an appropriate starting point."

The asset valuation adopted in this decision was "locked in" through a set of fixed principles included in the ACCC's access determination, and will be rolled forward for the purposes of future price resets for Telstra's declared fixed-line services.

(b) Approach to valuation of energy network assets

The ACCC has similarly noted in the context of energy network regulation that there is no singularly correct approach to asset valuation.

In its *Draft Statement of Principles for the Regulation of Transmission Revenues* (May 1999) the ACCC noted the absence of any clear economic answer to the asset valuation question, and emphasised the need for exercise of regulatory judgement in determining RAB values. The ACCC stated:

"In determining an appropriate asset valuation methodology economic principles and analysis do not provide an unambiguous decision rule for the valuation of existing sunk assets. Rather economic principles provide lower and upper bounds – scrap value and replacement cost. Within these bounds there is opportunity for regulatory judgement."

RAB valuations for most electricity network businesses are now, in effect, locked in under the National Electricity Rules (NER), with provision for roll-forward at each price/revenue reset for new capital

²⁵ ACCC, *Public inquiry to make final access determinations for the declared fixed line services: Discussion Paper*, April 2011, pp 44-45.

²⁶ As noted by the ACCC in its final decision, while the ULLS price was to remain relatively stable under its valuation approach, prices for other regulated services, particularly the line sharing service (LSS), wholesale line rental (WLR) and the local carriage service (LCS), would fall (ACCC, *Inquiry to make final access determinations for the declared fixed line services: Final Report*, July 2011, pp 44-45).

²⁷ ACCC, *Inquiry to make final access determinations for the declared fixed line services: Final Report*, July 2011, p 43.

expenditure, disposals, depreciation and inflation.²⁸ These locked in valuations are mostly the product of asset valuations undertaken in the 1990s by jurisdictional regulators, using different methodologies and having regard to various considerations.

For example, the valuations for each of the five electricity distribution networks in Victoria were all set around the time of privatisation of those utilities, and were set with the express objective of providing uniformity of pricing for customers across urban and rural areas of Victoria. The objective of price uniformity was given such primacy in the setting of asset values that explicit adjustments needed to be made to estimated DORC values for each of the five businesses in deriving the final valuations. For businesses operating rural parts of Victoria, a downward adjustment to the estimated DORC values was required, while for businesses in metropolitan areas there was an upward adjustment to estimated DORC values. The final valuations for each of the businesses (as at 1 July 1994), and the explicit adjustments made to arrive at these valuations, are set out in Table 1 below.²⁹

Table 1: Asset valuations for Victorian electricity distribution businesses (\$m, as at 1 July 1994)

	Eastern (now SP AusNet)	Powercor	Solaris (now Jemena)	Citipower	United
DORC estimate	1,046	1,227	361	482	743
Adjustment for equalisation of tariffs	(218)	(161)	61	129	136
Adjusted opening asset value	828	1,066	422	611	879

Source: *Victorian Electricity Supply Industry Tariff Order 1995 (Vic)*, 5.10(b).

For gas networks and pipelines subject to tariff regulation, RAB values have been set using various methodologies, including actual/historic cost, DORC, ODV and some hybrid methodologies. This may in part reflect the fact that the previous Gas Code expressly allowed for various valuation methodologies to be taken into account.³⁰

For example, a hybrid asset valuation methodology was adopted by the West Australian Office of Gas Access Regulation (**OffGAR**) for the Mid-West and South-West Gas Distribution Systems, owned by WA Gas Networks (formerly AlintaGas). The valuation approach for these distribution systems used DORC as a starting point, but with reductions to ensure that resulting tariffs would be consistent with an acceptable tariff outcome for consumers.³¹ In adopting this approach the took into account the balance of interests between the service provider and users, and considered various methodologies. OffGAR states in its final decision:³²

"In assessing the value of the Initial Capital Base proposed by AlintaGas, the Regulator considered several alternative valuation methodologies, the valuations that arise from these methodologies, and the

²⁸ National Electricity Rules, Chapter 6, Schedule 6.2 (for distribution), and Chapter 6A, Schedule 6A.2 (for transmission).

²⁹ *Victorian Electricity Supply Industry Tariff Order 1995 (Vic)*, 5.10(b).

³⁰ Section 8.10 of the gas code provided for various factor to be taken into account in valuing the initial capital base. These included "the value that would result from taking the actual capital cost of the Covered Pipeline and subtracting the accumulated depreciation for those assets charged to users" (8.10(a)) and "the value that would result from applying the "depreciated optimised replacement cost" methodology in valuing the Covered Pipeline" (8.10(b)).

³¹ OffGAR, *Final Decision: Access Arrangement – Mid-West and South-West Gas Distribution Systems – Submitted by AlintaGas*, June 2000, Part A, pp 12-14.

³² OffGAR, *Final Decision: Access Arrangement – Mid-West and South-West Gas Distribution Systems – Submitted by AlintaGas*, June 2000, Part A, pp 13-14.

advantages and disadvantages of each methodology and valuation in the context of the distribution systems.

In determining the most appropriate Initial Capital Base for the AlintaGas gas distribution systems, the Regulator considered a balance of interests between AlintaGas, Users and Prospective Users. The Regulator accepted that AlintaGas's proposal to set the Initial Capital Base to be consistent with retail gas prices expected to prevail in the gas market during the Access Arrangement Period would provide a reasonable balance of interests between the relevant parties."

These examples show how regulators have balanced various considerations in arriving at asset valuations. In each of the cases referred to above, price impacts for customers have been an important consideration, and have led to explicit adjustments being made to the final asset value. In several of these cases, the adjustments made to account for customer pricing impacts have led to a value lower than DORC being adopted.

4.2 Relevant judicial authority

In a small number of cases, matters of asset valuation have been considered by the courts or by the Australian Competition Tribunal (**Tribunal**).

(a) High Court decision in relation to the Moomba to Sydney pipeline

In the case of the Moomba to Sydney gas pipeline, the High Court was asked to consider permissible approaches to asset valuation under the Gas Code. The Gas Code (which is no longer in operation) had referred to a range of methodologies which could be used to set a value for a pipeline's initial capital base (ICB). The question before the High Court was whether the methodology adopted by the ACCC for the Moomba to Sydney pipeline ICB was permissible under the Code.

As observed by the High Court, the objective of the Gas Code access regime was (similar to the objectives of Part 5 of the QCA Act) to allow recovery of efficient costs for infrastructure owners, while preventing supra-competitive pricing. The High Court observed:³³

"The framework for third party access to natural gas pipelines set out above directs attention to the multiple objectives of an approved access regime. Stripped to essentials, such a regime is at least intended to allow efficient costs recovery to a service provider and at the same time ensure pricing arrangements for the consuming public which reflect the benefits of competition, despite the provision of such services by monopolies. The balancing of those objectives properly has a natural flow-on effect for future investment in infrastructure in Australia."

The High Court then went on to identify the range of asset valuation methodologies that were permissible under the Gas Code regime, which included (but were not limited to) DAC and DORC. Importantly, it was observed that a range of methodologies were available, and that the regulator had a "wide but limited" discretion in choosing between them. The High Court noted:³⁴

"The primary and natural significance of the words used in, and the structure of, s 8.10(a)-(d) mandates consideration of values derived from "well recognised asset valuation methodologies" followed by a comparative weighing up of these approaches to valuation. It is clear that a range of well recognised asset valuation methodologies can be considered and within that range a choice of value may be made. The discretion permitted is wide but limited. The reference to well recognised asset valuation methodologies emphasises that valuation, in this context, is a practical exercise."

Ultimately, the High Court decided that the approach taken by the ACCC in relation to the ICB for the Moomba to Sydney pipeline fell outside the range of asset valuation methodologies that were permissible under the Gas Code regime. Accordingly, the earlier decision of the Tribunal to vary the ACCC's methodology was upheld.

³³ *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* [2007] HCA 44, [49].

³⁴ *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* [2007] HCA 44, [51].

(b) Tribunal decision in relation to Telstra's fixed-line assets

In a more recent case, the Tribunal had cause to consider what approaches to asset valuation would be most likely to promote efficient use of, and investment in, infrastructure. In its review of the ACCC's decision of Telstra's 2008 draft access undertaking, the Tribunal considered the approach to asset valuation underpinning Telstra's proposed prices, against the relevant statutory criteria.

As part of the TSLRIC+ pricing methodology which was applied at that time,³⁵ Telstra had adopted a replacement cost methodology to value the assets used to supply the ULLS, with replacement costs estimated on the basis of a "hypothetical new entrant". The Tribunal indicated that it did not consider this approach would be consistent with the applicable statutory criteria, including because it would not promote economically efficient use of Telstra's network, or efficient investment by Telstra or access seekers. The Tribunal's primary concern was that the costs of a hypothetical new entrant would not reflect the costs actually faced by Telstra in respect of its sunk network assets, and as such, pricing on this basis would not drive efficient investment decisions.

The Tribunal stated:³⁶

"The price estimated by the TEA Model is based on the cost of a new entrant starting all over again and building a copper-based CAN from scratch, but using a scorched node approach in which cable routes are constrained to be at best a subset of those laid over many decades in Telstra's legacy access network...

Such a price would not encourage the economically efficient use of Telstra's network infrastructure unless the price reflects the long-run costs to the community of the resources tied up in, and used to operate, the ULLS (s 152AB(2)(e)). If, say, the costs of a hypothetical new entrant (and hence the price of the ULLS to an access seeker) were higher than Telstra's costs of supplying the ULLS to itself, then Telstra would have an advantage providing retail voice and broadband services to end-users. Given that the network is in place, but is to be or may be in the future replaced by, or at least compete with, the NBN, the long-run costs to the community of those resources are not those of a new entrant hypothetically building a replacement copper access network within the constrictions permitted by the TEA Model at present.

For the same reason, such a price would not encourage efficient investment by access seekers. It would not reflect the true resource costs to the community of providing the ULLS (i.e. the opportunity cost of not being able to use those resources in a higher value way). And such a price would have no bearing on Telstra's investment decisions, since it does not reflect costs actually faced by Telstra, which has trenches, ducts, etc already in place (s 152AB(2)(e))...

Nor would such a price reflect Telstra's legitimate business interests, which are to receive a commercial return on its prudent (past) investment in the infrastructure used to supply the ULLS, not a hypothetical new investment (s 152AH(1)(b)).

Whether such a price had due regard to the interests of access seekers turns on the same condition that determines whether the price would promote (efficient) competition, viz whether they would face the same cost in purchasing the ULLS as Telstra faces in using it to supply retail services (s 152AH(1)(c)). But there is no relation between that cost and that of a hypothetical new entrant. As already stated, such a price does not reflect the direct costs of providing access (s 152AH(1)(d))."

Ultimately, the Tribunal upheld the ACCC's decision to reject Telstra's draft access undertaking.

Subsequent to this decision, the legislative framework for regulation of Telstra's declared fixed-line services has changed, and the ACCC has also changed its approach to the determination of access prices. As noted above, the ACCC has now transitioned from the TSLRIC+ methodology to a building block model for pricing of Telstra's declared fixed-line services, and in doing so has locked in a value for the underlying assets which is between DAC and DORC.

³⁵ TSLRIC+ stands for total service long-run incremental cost, plus a contribution to common costs. The TSLRIC+ methodology was applied by the ACCC to determine prices for declared access services in the telecommunications sector until 2011. Since 2011, the ACCC has applied a building block methodology to determine prices for declared telecommunications services.

³⁶ *Application by Telstra Corporation Limited* [2010] ACompT 1, [240]-[245].

5 Relevant factors bearing on the choice of valuation method and determination of the reference tariff

New Hope has asked whether the sustainability and competitiveness of access seekers' coal mining operations could be a relevant factor bearing on the choice of asset valuation methodology and determination of the reference tariff, in the particular case of Queensland Rail's Western System assets.

5.1 Relevant factors

We have noted that there are potentially a range of factors affecting the QCA's decision to approve a draft access undertaking. These include (but are not limited to):³⁷

- the object of Part 5 of the QCA Act, which is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of persons who may seek access to the service; and
- any other issues the QCA considers relevant.

In this context, the sustainability and competitiveness of Western System users would be a relevant matter in consideration of the appropriate asset valuation methodology for Western System assets, and in any assessment of the draft access undertaking more generally. The object of Part 5 of the QCA Act is explicitly directed at promoting effective competition in *upstream* and *downstream* markets, which implies that the effect of access prices on the competitiveness of access seekers in upstream and downstream markets should be a relevant factor. Other relevant factors listed in section 138 of the QCA Act would also support taking this into account, including the interests of access seekers and the public interest in promoting competition in markets (and particularly Australian competitiveness in international markets³⁸).

5.2 Bearing on the choice of asset valuation methodology

In this case, we consider that the effect on access prices and the sustainability and competitiveness of access seekers' coal mining operations would be a relevant consideration bearing on the choice of asset valuation methodology. If adopting a particular methodology would be likely to have the effect of seriously damaging the sustainability and competitiveness of Western System users, this may indicate that a different methodology which did not give rise to the same risk was more consistent with the statutory criteria.

Clearly there will be other relevant matters to be taken into account, such as the legitimate business interests of the service operator. However each of these matters need to be appropriately balanced, having regard to the particular circumstances of this case.

5.3 Bearing on determination of tariffs for the current period

Once an appropriate asset valuation is established, there are further decisions to be made about how capital costs will be recovered over the life of the relevant assets, and how these capital costs will feed into the determination of tariffs. This is another area in which the sustainability and competitiveness of

³⁷ *Queensland Competition Authority Act 1997* (Cth), s 138.

³⁸ While not explicit under the QCA Act, the relevance of international competitiveness to the application of a similar 'public interest' test applied under the Competition and Consumer Act 2010 is referred to explicitly in section 90(9A).

access seekers' coal mining operations may be a relevant factor for the regulator to consider. The key issue for the regulator in this respect will be the appropriate capital cost recovery profile (as opposed to the total amount to be recovered, which is more relevant to the question of asset valuation), as this will affect the path of tariffs over time.

There are various ways in which capital costs may be recovered over the life of the relevant assets. While some approaches are more commonly applied than others, there is certainly no one approach that will necessarily be appropriate for all circumstances.

The key mechanisms by which the cost recovery profile may be adjusted are the depreciation profile, treatment of asset inflation, and use of loss capitalisation accounts. Some options in this respect include:

- real straight-line depreciation with no loss capitalisation (i.e. real straight line depreciation is recovered through user charges in the year or period in which it is incurred);
- nominal straight-line depreciation with no loss capitalisation;
- 'tilted' depreciation profiles (i.e. back-loading or front-loading of depreciation);
- 'tilted' annuities (i.e. back-loading or front-loading of capital cost recovery, including both depreciation and the return on capital);
- application of straight-line depreciation, but with tariffs set below cost recovering level in early periods and losses capitalised for later recovery.

In this particular context, the impact of tariffs on the sustainability and competitiveness of access seekers' coal mining operations would be a relevant factor in determining the appropriate cost recovery profile. If, notwithstanding the approach taken to asset valuation, adopting a particular approach to capital cost recovery would lead to tariff outcomes which are likely to seriously damage the sustainability and competitiveness of Western System users in the short to medium term, it may be appropriate to adjust the cost recovery profile to reduce tariffs in the near term (e.g. through deferral of some depreciation and/or loss capitalisation).

It should be noted that whatever approach is adopted to the capital cost recovery profile, this should be applied consistently over the life of the relevant assets, so as to avoid over-recovery or under-recovery of capital costs. This means that if a decision is taken to capitalise losses or defer depreciation to later periods, these deferred amounts should be allowed to be recovered later on. Consistency of approach is necessary to ensure that the regulated business has a reasonable opportunity to recover the efficient costs of providing access, over the life of the relevant assets.

Set out below are some examples of where regulatory frameworks expressly permit flexibility around the cost recovery profile and where adjustments have been made by regulators or service providers with a view to reducing prices and stimulating demand in the short to medium term.

(a) Express provision for flexibility around depreciation profiles under the National Gas Rules

The National Gas Rules (NGR) expressly contemplate that different approaches may be taken to depreciation for different gas pipelines, depending on the particular circumstances of each pipeline. The NGR also make explicit reference to possible deferral of depreciation in some cases, particularly where there is a need to keep tariffs low in the short-term, in order to stimulate demand.

The NGR do not prescribe a particular approach to depreciation which must be applied in all gas access arrangements. Rather, the NGR (in Rule 89) simply state that the depreciation schedule to be

applied in determining reference tariffs for a pipeline should be designed so as to satisfy the following criteria:³⁹

- so that reference tariffs will vary, over time, in a way that promotes efficient growth in the market for reference services;
- so that each asset or group of assets is depreciated over the economic life of that asset or group of assets;
- so as to allow, as far as reasonably practicable, for adjustment reflecting changes in the expected economic life of a particular asset, or a particular group of assets;
- so that (subject to the rules about capital redundancy), an asset is depreciated only once (i.e. that the amount by which the asset is depreciated over its economic life does not exceed the value of the asset at the time of its inclusion in the capital base (adjusted, if the accounting method approved by the AER permits, for inflation)); and
- so as to allow for the service provider's reasonable needs for cash flow to meet financing, non-capital and other costs.

Rule 89 further states that compliance with these criteria "*may involve deferral of a substantial proportion of the depreciation*", particularly where the where the present market for pipeline services is relatively immature and/or the pipeline has been designed and constructed so as to accommodate future growth in demand.⁴⁰

(b) Back loading of depreciation

Gas pipeline operators have in the past proposed deferral of depreciation on some pipeline assets, particularly newer assets where there is a need to stimulate demand.

For example, in proposing revisions to its access arrangement for the Victorian gas transmission system to roll-in its \$75.5 million Southwest Pipeline (**SWP**) investment, GPU GasNet proposed to defer depreciation in the early years of the life of the SWP. The main objective of this was to keep tariffs low in the early years, in order to stimulate demand. GPU GasNet proposed negative depreciation of \$2.7 million on the SWP over the first three years of its life, and proposed to defer a total of \$8.2 million in depreciation for recovery in later years (being the \$2.7 million of negative depreciation, plus \$5.5 million which would have been recoverable in the first three years under straight line depreciation). GasNet noted that this approach "*more closely matches the revenue requirement to the rate of growth of the load and avoids the disadvantages and inefficiencies of front-loaded tariffs on new pipelines with relatively low initial flows*".⁴¹

Pipeline users generally supported GPU GasNet's proposal for back loading of depreciation on the SWP, as it would have had the effect of reducing tariffs in the early years of the pipeline's life.⁴²

The ACCC rejected GPU GasNet's proposed revisions to its access arrangement for other reasons. However in its Final Decision the ACCC noted that back-loading of depreciation, as proposed by GasNet, may be appropriate in some circumstances. The ACCC commented in its Final Decision:⁴³

³⁹ National Gas Rules, Rule 89(1).

⁴⁰ National Gas Rules, Rule 89(2).

⁴¹ GPU GasNet Pty Ltd, *Application for Revision to Access Arrangement – Southwest Pipeline*, 11 September 2000, Annexure 3, p 24.

⁴² For example: AGL submission, 15 December 2000, p 2.

⁴³ ACCC, *Final Decision: Access Arrangement for the Principal Transmission System – Application for Revision by GPU GasNet Pty Ltd – Southwest Pipeline*, 29 June 2001, p 64.

"The Commission considers it appropriate that changing usage over time be reflected for regulatory purposes in the depreciation schedule. It has concluded that GPU GasNet's proposal to back-end load depreciation from October 2000 is not unreasonable."

(c) Use of tilted annuity profiles in telecommunications access pricing

Until recently, the ACCC applied a pricing methodology in the telecommunications sector which involved deferral of substantial amounts of depreciation. Under the TSLRIC+ methodology which applied to regulated fixed-line services until 2011, the ACCC calculated access prices using a positively tilted annuity profile. The effect of this was to reduce the amount of capital costs reflected in access prices in the short-term, relative to a straight-line depreciation approach (i.e. some capital cost recovery was deferred to later years). The ACCC's stated rationale for applying a positively tilted annuity was to align the path of prices over time with trends in input costs.⁴⁴

(d) Loss capitalisation under the ARTC Hunter Valley Access Undertaking

In the rail sector, loss capitalisation has been used as an alternative to deferral of depreciation. Under loss capitalisation, depreciation may be calculated for each year on a straight line basis, but tariffs are set below what is required to recover all capital costs for some period, with losses accrued in that period capitalised for recovery at some later stage.

The ACCC has approved loss capitalisation as a means of addressing short-term tariff impacts, in the context of ARTC's Hunter Valley Access Undertaking. Loss capitalisation was seen by the ACCC as a means of allowing cost recovery for ARTC over the long run, while ensuring that in the short term tariffs were not so high as to discourage efficient use of infrastructure (particularly new infrastructure),

The ACCC noted that:⁴⁵

"The intent of loss capitalisation is to allow under-recovery of economic cost for a period and then recovery of the relevant shortfall at a later date. In appropriate circumstances, loss capitalisation may therefore operate to facilitate investment in new assets where there is limited initial demand by allow initial under-recovery of relevant costs in the expectation of 'making up' the shortfall when demand reaches an appropriate level."

While the ACCC initially indicated that it would only allow loss capitalisation in respect of new assets, in its final decision it allowed loss capitalisation for both new and existing assets, on the basis that this was generally supported by users.⁴⁶

(e) Loss capitalisation under the NBN Co Special Access Undertaking

Loss capitalisation is also provided for under NBN Co's Special Access Undertaking, which was accepted by the ACCC in December 2013 (**NBN Co SAU**).

Under the NBN Co SAU, initial prices for NBN products and services are set at levels which are designed to encourage economically efficient take up and usage of those products, having regard to pricing of existing services and end-users' expected willingness to pay for new NBN services.⁴⁷ These initial prices are not linked to an assessment of NBN Co's costs, but rather are set so as to facilitate a smooth transition for customers from legacy networks to the NBN. As a result, it is expected that NBN Co will significantly under-recover its costs, at least for its first decade of operation.

⁴⁴ For example: ACCC, *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking: Final Decision*, April 2009, pp 255-275.

⁴⁵ ACCC, *Position Paper in relation to the Australian Rail Track Corporation's proposed Hunter Valley Rail Network Access Undertaking*, 21 December 2010, p 81.

⁴⁶ ACCC, *Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking*, 29 June 2011, pp 43-44.

⁴⁷ NBN Co, *Supporting Submission: NBN Co Special Access Undertaking*, 28 September 2012, Chapter 6.

The NBN Co SAU therefore includes a mechanism by which initial losses may be capitalised for later recovery. Under the NBN Co SAU, any losses accrued in the early years of NBN Co's operation will be added to an "initial cost recovery account".⁴⁸ Over the term of the NBN Co SAU, NBN Co may continue to increase prices for its services at an annual rate of CPI less 1.5% until the initial cost recovery account is fully extinguished (i.e. until all initial losses are recouped). Once the initial cost recovery account is fully extinguished, NBN Co will be subject to a traditional revenue cap.

6 Conclusion

Based on our review of the legislative provisions, the relevant background materials, and recent regulatory and judicial precedent, we conclude that the QCA is not bound to any particular asset valuation methodology in setting access prices under the QCA Act and its associated pricing principles.

The QCA Act requires that, a number of factors be considered and balanced under section 138. These factors include (but are not limited to), the object of Part 5, the pricing principles, the interests of both the service provider and access seekers, and any other issues the QCA considers relevant. Depending on the circumstances of a particular case, a balancing of these various factors may favour one methodology over another. It seems unlikely that one methodology would be preferable in all cases, having regard to these factors.

While there is a reference to the recovery of "efficient costs" in the first of the pricing principles in s.168A, we do not share the view of Queensland Rail that this necessitate or requires the adoption of a forward-looking asset valuation methodology such as DORC in all cases. It simply means that the service provider is only entitled to recover costs that are efficiently incurred, and will not necessarily be entitled to recover costs imprudently or inefficiently incurred. Clearly if past investments were prudent and efficient, the service provider should be entitled to recover the cost of those investments.

Finally, we note that there are numerous cases in which regulators have adopted methodologies other than pure DORC, when applying similar efficiency criteria. In several of these cases the regulator's decision on the asset value has explicitly taken into account the effects on pricing for customers, and values lower than DORC have been adopted in order to achieve acceptable price outcomes – the ACCC's 2011 decision in respect of Telstra and the OffGAR's 2000 decision in respect of AlintaGas are both examples of this.

Gilhub + Telen

22 April 2014

⁴⁸ NBN Co SAU, clauses 1E.5 (Module 1) and 2C.5 (Module 2).

Queensland Rail's proposed Reference Tariff Reset

New Hope Corporation submission

New Hope is the largest coal producer in Queensland Rail's Western System. New Hope is pursuing growth opportunities across its portfolio and seeks regulatory arrangements which promote efficient supply chain performance, reasonable, competitive and predictable charges for use of the Infrastructure, and a practical pathway to expansion.

1. Western System reference tariff derivation:

Reference tariffs in the Western System have, until now, emerged from processes involving the determination of the Access Undertakings of QR Network and its predecessors. Each of these processes failed to establish a transparent and repeatable methodology for the derivation of reference tariffs in the Western System.

The original access pricing for Western System coal producers is understood to have been derived in the late 1990's based on a nominal split of the negotiated integrated haulage charges into above rail and below rail components. The below rail portion was understood to be an amount equivalent to recovering the coal traffic's share of recurrent costs and incremental capital, but not a return on sunk capital.

It is our understanding that the reference tariffs currently in place had their origins in a draft decision of the Authority (December 2009) regarding QR Network's 2009 DAU. That draft decision set out the draft views of the Authority on a methodology for the development of Western System reference tariffs. As QR Network subsequently withdrew its 2009 DAU, a final decision was never required. In the 2010 DAU, QR Network rejected the Authority's approach to setting Western System tariffs, but accepted a tariff which was consistent with the 2009 draft decision, which was then approved. The result was that the methodology was never finally established. Despite this, Queensland Rail has based much of its proposal on the draft decision of December 2009.

New Hope welcomes the proposal to establish a transparent and repeatable methodology. However, given that previous consultation processes were incomplete, it is important that the proposed methodology be fully assessed on its merits. Further, New Hope considers that the methodology proposed by Queensland Rail is appropriate for calculating a ceiling price only. The decision of where to set tariffs (i.e. at the ceiling or at a discount to the ceiling) requires careful consideration of matters such as the impacts of pricing on the competitiveness of customers, and the reasonableness of the tariff given the quality of service provided.

2. QCA's criteria for evaluating tariff proposals

In forming a judgement on the actual tariffs (as opposed to the ceiling price), the QCA's recently finalised Statement of Regulatory Pricing Principles¹ established criteria for the evaluation of regulated tariffs, revolving around three primary concepts:

- **Economic efficiency:** Are the pricing arrangements consistent with achieving economic efficiency?
- **Fairness:** Are prices consistent with reasonable expectations formed from prior transactions and is there proportionality in the treatment of different users? If a subsidy is applicable, is the rationale well developed?
- **Regulatory governance and practice:** Are the processes for establishing prices transparent and are changes in prices predictable?

We consider that these criteria provide a strong analytical basis for the assessment of the Western System reference tariffs, and as a result Section 2 of this submission is structured around these three key elements.

2.1. Efficiency criteria – is the proposed tariff efficient?

In its Statement of Regulatory Pricing Principles, the QCA identified that the primary consideration in evaluating whether a specific pricing proposal or structure is justified from a public policy perspective is whether it is clearly consistent with increasing overall economic efficiency (comprehensively defined) on a net present value basis.

Efficiency in this respect includes:

- *allocative efficiency:* this essentially requires allocating scarce resources to their most highly valued uses. Allocative efficiency is dependent on output being produced at a level consistent with price being equal to short-run marginal cost.
- *productive efficiency:* which requires that output is produced at minimum cost.
- *dynamic efficiency:* this encompasses the intertemporal aspects of efficiency including the timely and profitable introduction of new processes, systems and services.

New Hope acknowledges that these concepts of efficiency must be considered in combination with the required pricing principles as set out in section 168A of the QCA Act, which requires that prices:

- generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved;
- allow for multi-part pricing and price discrimination when it aids efficiency;

¹ QCA – Statement of Regulatory Pricing Principles, August 2013

- not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent the cost of providing access to other operators is higher; and
- provide incentives to reduce costs or otherwise improve productivity.²

In the context of the Western System, New Hope believes that there is an important distinction between the investments that Queensland Rail has made, and will continue to make, to enable the operation of coal services in the Western System, and the DORC value attributed to infrastructure assets that existed prior to the commencement of coal services in the Western System. Recognising that these assets had previously been written down to a scrap valuation, recovery of the DORC valuation on these assets is clearly not required from a 'revenue sufficiency' perspective.

The extent to which Queensland Rail is seeking to include recovery of the DORC valuation of pre-existing assets into its prices is making the Western System highly uncompetitive when compared to other coal supply chains in Queensland and NSW. As a result, New Hope considers that Queensland Rail's proposed tariffs will not promote overall economic efficiency.

Levying a tariff at the proposed level will not meet the objectives of Section 138 of the QCA Act, for the reasons set out in Section 5 (Conclusion).

New Hope considers that setting a reasonable and efficient tariff will require some combination of:

- Revising/correcting certain elements which lead to the high ceiling price, e.g. the excessive operating and maintenance costs; and
- Recognition that the tariff must support a sustainable capacity to pay, on the part of coal producers. This should be addressed by:
 - Recognising that the value of the RAB must be reduced from the theoretic DORC value (i.e. the asset value arising from the theoretic DORC approach cannot be sustained and must be impaired) AND/OR
 - If required to ensure a reasonable tariff, charging tariffs which are below a ceiling price, perhaps in conjunction with a 'loss capitalisation' approach (as is adopted by ARTC in Zone 3 in NSW, which results in a charge per '000 gtk of around \$7).

Section 3 below sets out New Hope's concerns regarding the elements which contribute to Queensland Rail's estimation of the proposed \$22.22/'000 gtk tariff.

2.2. Fairness criteria - is the proposed tariff reasonable?

In its Statement of Regulatory Pricing Principles, the QCA has proposed that a central concept in considering the fairness of tariffs is the 'reference transaction'. It has emphasised the need to establish a reasonable reference transaction to determine what all parties to the transaction would regard as fair from an ex ante perspective. The ex-ante perspective effectively requires addressing the

² Section 168A of the QCA Act

question of what principles all parties to a transaction would have agreed to before they made any sunk investments.³

New Hope acknowledges that establishing a reasonable reference transaction in respect of the West Moreton system coal tariffs is not straightforward for a number of reasons, including:

- Rates that were negotiated prior to making sunk investments in mine and rail infrastructure often related to an integrated haulage service, with no transparency on the specific access charge component; and
- Rates were not negotiated at a single point in time.

However, notwithstanding these difficulties, New Hope considers that there are number of principles that underpin our view on the reference transaction that would have applied prior to the investment in sunk mine and rail infrastructure:

- Both parties would have expected that the tariff would have covered all incremental operating and maintenance costs associated with coal traffics, plus a reasonable usage based allocation of fixed operating and maintenance costs;
- Both parties would have expected that the tariff would have covered all incremental capital expenditure that was required to be spent on the railway – indeed, most of the incremental capital expenditure was contributed upfront by the users, with rebates provided to the extent that this expenditure is also included in the tariff;
- Importantly, neither party would have expected that Queensland Rail would recover the full DORC value of its pre-existing assets. In fact, we are aware that, in 1995, QR (as it was then known) valued its Western System rail infrastructure at a scrap valuation. We do acknowledge that Queensland Rail would likely have anticipated an increase in profitability as a result of the introduction of coal traffic, and as a result of subsequent volume increases. In a regulatory sense, this would be viewed as making some contribution to the value of pre-existing assets. However, the primary determinant of the tariffs would have been the need to ensure that the Western System supply chain remained competitive with the supply chains available to alternate mine developments. To the extent that Queensland Rail could remain competitive with other systems, it would have the opportunity to achieve a return on its pre-existing written down assets.

New Hope believes that it is critical to acknowledge that, recognising the poor below rail service quality, the need for the Western System to be competitive with other systems and the need for tariffs to be sustainable for users, it was never anticipated that tariffs would be set at a level that provided for full recovery of the DORC value of pre-existing assets.

Given this, New Hope's overriding concern is the quantum of the tariff, which we consider far exceeds any reasonable view of the applicable reference transaction and must therefore be reduced regardless of the views of the Authority on the appropriate ceiling price.

We have considered the fairness of the proposed tariff from the following perspectives:

³ QCA Statement of Regulatory Pricing Principles, August 2013, p 27-28

- Have the increases been reasonable over time?
- Are the tariffs competitive with other systems?
- Is competitiveness further impacted by the below rail service impacting above-rail costs?
- Are the tariffs sustainable for customers?

2.2.1. Have the increases been reasonable over time?

Western System tariffs have increased as follows:

- 2005 draft decision \$8.50/'000 gtk.
- 2006 decision \$10.50/'000 gtk.
- 2010 decision \$16.81/'000 gtk.
- 2013 QR claim \$22.22/'000 gtk.

The notional \$22.22 per thousand gross tonne kilometres is proposed by QR to be split into a two part tariff of \$11.11 per thousand gross tonne kilometres plus a per train path tariff of \$5,449.78. When the two part tariff is calculated it results in an access charge of \$10.13 per tonne. The \$10.13 per tonne is actually equivalent to a single tariff of \$24.60 per thousand gross tonne kilometres. The tariff is now proposed to increase to a level 2.9 times that of the 2005 draft decision level which was a single gtk based tariff, only eight years ago. Given that CPI has risen approximately 25% over this period, it is difficult to understand how such large increases can be justified in the context of the lower WACC which applies under current market conditions, a depreciating asset base and substantial volume increases (which have required only limited capital expenditure). Rather, it is clear that the major driver of the increasing tariff is Queensland Rail's escalating demands for recovery of the DORC value of its pre-1995 assets:

- In 1995, QR placed a scrap value on its rail infrastructure assets in the Western System – given an estimated scrap value of \$10,000/km, this would translate to a valuation of just over \$2 million from Rosewood to Macalister;
- The value placed on pre-1995 assets in the 2005 and 2006 decisions was not identified, however, the Authority's 2005 final decision⁴ referred to a benchmark DORC value for the Western System of \$1.5m/km, 70% life expired, which would translate to around \$95 million from Rosewood to Macalister;
- The Authority's 2010 decision reflected Everything Infrastructure's valuation of pre-1995 assets of \$177.1 million (August 1997 \$'s);
- Queensland Rail's 2013 proposal includes a value for pre-1995 assets of \$248.1 million (August 1997 \$'s) for Rosewood to Columboola.

⁴ QCA's Final Decision on QR's 2005 Draft Amending Undertaking, December 2005, p75

New Hope considers that this massively increasing expectation for recovery of pre-1995 assets is completely at odds with the 'reference transaction' applicable prior to sunk investment being made in mine and rail infrastructure.

2.2.2. Are the tariffs competitive with other systems?

When considering the reasonable expectations about the extent of recovery of the DORC valuation of pre-1995 assets, it is instructive to consider how Western System tariffs compare to the tariffs paid in other coal systems. This comparison is important, given that the 'reference transaction' was established prior to sunk investment in mine and rail infrastructure. At the time it would have been essential for the Western System to provide a cost competitive haulage service when compared against the options available for mine developments in other systems. There is a continuing need for Western System mines to remain competitive with mines located in other coal systems.

The Authority recognised this in its July 2005 draft decision, where it concluded that the tariffs paid in other Queensland coal systems were an appropriate benchmark for Western System reference tariffs, and recommended a tariff for the Western System equivalent to the Moura system (the most expensive of the central Queensland systems at the time).

The table below demonstrates the extreme extent to which the proposed Western System tariff is now out of step with below rail tariffs in other systems. The potential to distort the competitive position of coal mines is clear from this table alone. Note however that this table excludes the impact on the competitive position which arises from high above-rail costs in the Western System, which are a further consequence of the inferior below rail service.

Figure 1. Comparisons of below rail costs

Year Tariffs apply to Selected Coal System	2013 Tariffs	2013	2006 Tariffs	2006	Increase 2006 - 2013	Proportion Coal Type
Selected Systems	\$/'000 gtk	Indicative \$/net tonne	\$/'000 gtk	Indicative \$/net tonne	Indicative % increase	Metcoal/Thermal Coal %
QR West Moreton	24.6*	10.13	10.5	4.3	134%	0/100
Blackwater AT1-4	~ 9	3.8	~ 5	2.3	65%	64/36
Goonyella AT1-4	~ 7	2.4	~ 5	1.7	41%	88/12
Moura	~ 9	2.8	~ 8	2.5	12%	28/72
Gunnedah (Zone 3), NSW	7.2	5	Not available	Not available	Not available	15/85
Hunter Valley (Zone 1), NSW	~ 10	1.5	~ 7	1	50%	15/85

*Note that the two part tariff is equivalent to \$24.60 which exceeds the notional \$22.22 headline tariff

The tariff proposed by Queensland Rail (shown in red) is clearly out of step with other systems, being more than double the next most expensive system in \$ per '000 gtk terms. The Goonyella Abbot Point Extension has been excluded from this analysis on the basis that it is a green-field railway construction in the ramp-up phase. The proposed increase in tariff is the highest in percentage terms by far and is more than double the percentage increase of the Blackwater and Goonyella systems which have experienced significant investment between 2006 and 2013. It could be argued that the investment in Moura and West Moreton systems has been the most similar over this period.

In each of these other systems, coal trains are able to run virtually 24 hours per day and to carry payloads of at least 6,000 tonnes and in some cases in excess of 10,000 tonnes. Queensland Rail's proposal is to charge 2-3 times the average tariff of other systems, while providing a vastly inferior service.

Interestingly, in the case of the Gunnedah system in New South Wales, the tariff of approximately \$7.20/000/Gtk is a result of ARTC voluntarily deferring returns (through a 'loss capitalisation' mechanism), based on considerations of capacity to pay. This is despite the superior service offered in this system, with train payloads of 6,000t compared to 1,940t in West Moreton, and with 24 hour operation. In this case, Queensland Rail's proposal is to charge more than triple the tariff which ARTC considers is the maximum which its customers can bear, while providing a service which also results in significantly higher above rail costs. New Hope does not consider this proposal to be remotely reasonable. In a competitive sense, the access tariff should be well below \$7.20/000/Gtk to compensate for the below rail service quality impacts on above rail costs. In order for below rail charges to be equivalent to the highest charges in other rail systems, the Western System tariff would need to reduce by at least \$5.00/tonne. However, when the additional costs imposed on rail operations as a result of the poor below rail service standards are taken into account, for Western System rail costs to be equivalent to other systems, the access charge would need to be no more than \$2/tonne to be competitive with the next highest rail cost corridor (Upper Hunter/Gunnedah).

The following section discusses the impacts of the poor below-rail service quality in the West Moreton system on above-rail costs.

2.2.3. Is competitiveness further impacted by the below rail service impacting above-rail costs?

Attachment A, which is confidential, provides indicative ranges of above-rail costs compared to Western System mines. [REDACTED]

[REDACTED] This is highly significant in the market for thermal coal having a moderate price level, as outlined in Section 2.2.4.

The causes of the above-rail cost disadvantage all relate to the below rail service offering. The causes are:

- **Low system volumes, caused by lack of below rail capacity:**

Railways have enormous scale economies. In the case of the Western System, scale is limited by government endorsed restrictions on rail capacity allocated to coal and legislatively imposed restrictions including passenger priority legislation. Low volumes in the Western System result in higher unit costs of rail services due to loss of economies of scale, and a lack of competition resulting from insufficient scale to sustain more than one operator. This lack of scale also restricts the ability of mines to produce at an optimal mining operation scale, further impacting on unit costs of coal production and hence competitiveness.

- **Restricted operating hours:**

The primacy of the passenger traffic in South-East Queensland results in an inability to run trains for 24 hours per day, because of the non-passenger train movement restrictions during the passenger peak and shoulder peak periods. Even outside of peaks, Queensland Rail proposes to operate a 15 minute frequency of passenger trains on a broader scale.

Beyond this, in recent years Queensland Rail has introduced regular 48 hour closures of segments of the metropolitan system to optimise its maintenance approach given the demands of

passenger traffic. These 48 hour closures disproportionately impact coal services, which rely on weekend running to meet service requirements and need to transverse multiple 'passenger segments'.

The 'blackout' periods and severe shoulder peak restrictions lead to scheduling disruptions for train crew and loss of train movement efficiency. These restrictions impact on the train crew hours required to operate train services as well as the size of the fleet required.

- **Short train lengths and low axle loads limit payloads:**

The historical limitations of a rail network predominantly built for non-coal traffic result in restrictions to maximum train lengths (crossing loop length) and total axle loads (15.75t), resulting in inefficient payloads of 1,940t. This is very low when compared to 8,200 - 10,000t payloads in Central Queensland and 6,500 to 9,200t payloads in Hunter Valley.

- **Operational limitations:**

Operational limitations are a constant feature of the Western System due to old and inadequate system design. This results in:

- Frequent maintenance closures and consequential loss of throughput.
- Frequent speed restrictions.
- Inability to use modern AC drive locomotives primarily because of axle load and size restrictions. AC drive locomotives are technically more efficient due to higher adhesion levels, i.e. for the same locomotive weight, an AC drive locomotive can typically haul 50% more wagons per locomotive.

- **Prevention of effective above rail competition perpetuating the use of out-dated rollingstock:**

The nature of the below rail infrastructure, including the 15.75 tonne axle load limit, represents a barrier to entry and reduces the feasibility of above-rail competition. New 15.75 TAL locomotives are generally required to be custom designed and manufactured in low volumes and consequently are more expensive. In contrast with the other rail systems where above rail competition is vigorous, the below rail infrastructure constraints mean that producers have very limited options for encouraging competition in the above rail market.

If the below rail service offering facilitated more above rail competition, we believe that new above rail operators would be more likely to invest and install heavier, longer and faster rolling stock. Additional costs of using the existing rollingstock include:

- Lower tonnage throughput for the same number of train services and hence lower operator revenue opportunity;
- Existing life expired locomotives are 30 to 40 years old with a fuel burn around 20-25% greater than the modern diesel engine technology.
- Lower tractive effort locomotives constrain the maximum payload for two locomotives to less than 2000 tonnes per train consist.

- Lower horsepower impacts the cycle time through lower average speed and therefore also increases crewing costs.
- High maintenance costs due to more frequent servicing and unplanned maintenance of older rolling stock.
- Increased spare part costs are incurred because of low volume manufacturing of out of date spare parts and redesign costs for spare parts substitution.

2.2.4. Are the proposed tariffs sustainable for customers? [REDACTED]

Thermal coal is a global commodity and Australian producers are competing in Asia against coals produced in the Atlantic (Colombia/USA/ South Africa) and Pacific rims (Indonesia/Russia). Coal producers in the Western System are also competing with producers from NSW and Queensland. Commodities are highly substitutable and therefore the major point of competition for thermal coal is the delivered price.

[REDACTED]

It is also important to note that 100% of coal being transported on the Western System is thermal coal whereas other rail systems in Queensland are carrying predominantly metallurgical coal (e.g. Goonyella system), or at least a much lower percentage of thermal coal. FOB prices received for low ash thermal coal are significantly lower on average than for metallurgical coal. From Japanese Fiscal Year 2000 to 2013, the USD FOB price for low ash thermal coal sold in Japan was on average only 50-55% of the hard coking coal price over the same period.

[REDACTED]

When compared against the volatile thermal coal price, and given the level of price competition in coal markets, consistent increases in rail costs from an already high level will not be matched over a sustained period by the coal price. This leads to significant margin erosion for coal producers utilising the Western System. Coal producers using the Western System are also producing thermal coal only, yet are paying the highest tariffs.

In addition the high increase in above rail charges over the period in question brings into focus two issues:

- the lack of competition and the impacts of the below rail service, as discussed in Section 2.2.3; and
- the likelihood that QR's initial split of the integrated rail haulage rates into to above and below rail allocated an insufficient amount to above rail. The effect of this is that the allocated above rail rate did not reflect the true costs of the haulage service and once haulage rates were renegotiated, the rail operator sought a rate that did in fact reflect the full costs of this service. The corollary of this is that the initial split of rates allocated an excessive amount to below rail, which was then treated as providing a contribution towards value of pre-existing infrastructure assets.

The high increase in above rail charges reinforces New Hope's concerns that Queensland Rail's demands for recovery of the DORC value of pre-existing infrastructure assets is completely inconsistent with the 'reference transaction' that was established prior to investment in the mine.

2.2.5. Fairness of proposed tariff: Conclusion.

New Hope submits that the tariff proposed by Queensland Rail does not meet the fairness criterion as it far exceeds any reasonable view of the appropriate 'reference transaction' given that:

- Increases over time have been excessive and have, in large part, been driven by Queensland Rail's escalating demands for recovery of a DORC value of pre-1995 assets.
- The proposed tariff is at least double that of other coal systems which offer vastly superior below rail service.
- The below rail service quality in this system has severe impacts on above rail costs and maintains a barrier to entry for new operators.
- Customers cannot remain competitive while dealing with both unsustainably high below rail charges and an inferior below rail service offering that contributes to overall higher haulage charges.

2.3. Regulatory governance and practice criteria – achieving transparency and predictability in tariff reviews

New Hope considers it essential to establish a transparent and repeatable methodology for determining reference tariffs for the Western System. We believe that this will enable greater predictability of tariffs, and hence improved understanding and management of the associated cost risk.

However, contrary to the apparent view of Queensland Rail, we do not consider that a transparent and repeatable methodology for assessing reference tariffs should automatically mean that tariffs are set at the price ceiling. Instead, the primary objective is to establish what is the reasonable level of tariffs, taking account of the efficiency and fairness pricing criteria, and then to specify a framework for repeating this process into the future.

This may well result in a methodology that involves:

1. A building block assessment of the ceiling price; and
2. A specified methodology or factors for adjusting this ceiling price to derive the reference tariffs.

In this context, New Hope provides, in Section 4 of this submission, detailed comments on each of the elements (building blocks) which lead to the proposed tariff. Those sections will explain why, in our view, the ceiling price should be lower than the notional \$22.22 per '000 gtk (equivalent tariff of \$24.6 compared to the two part tariff). Our main concerns, as detailed in Section 4, are that:

- The DORC value of the assets is excessive, given the actual condition of the infrastructure (and resulting high maintenance and ongoing sustaining capital expenditure requirements) together with the poor below rail service levels available using this infrastructure; and

The forward looking operating and maintenance costs, and capital expenditure, all appear to be far higher than would be expected from an efficient service provider.

3. Queensland Rail's Methodology

This section provides comments on Section 3 of Queensland Rail's submission, adopting the same numbering and headings.

3.1. Building Blocks approach

The building block approach is considered reasonable in establishing a ceiling price level, subject to New Hope's concerns regarding the overstatement of the value of the pre-existing rail infrastructure. These concerns are discussed in Section 4 in relation to the opening asset value.

3.2. Inclusion of Macalister to Columboola

New Hope has no reason to object to Macalister to Columboola being included. Without access to transparent information we will rely on the QCA determining a fair and equitable allocation of common and other costs.

3.3. Brisbane Metropolitan Region

Queensland Rail has proposed to apply the building blocks based tariff derived for Rosewood to Columboola to the distance travelled through metropolitan system. There is no justification provided for this apart from that calculation of a ceiling price would be complex and would be likely to be higher than for Rosewood to Columboola.

In the Brisbane Metropolitan Region the passenger rail services are the prime user and infrastructure is optimised for that user. Coal and other freight traffics are incremental users who receive lower service levels from the infrastructure manager.

New Hope considers that there is no case whatsoever for additional costs incurred on the Rosewood to Columboola section to result in increased charges through the metropolitan region.

Rather, in the absence of clear cost based information on the floor and ceiling price for this region, consideration of the parties expectations reflected in the 'reference transaction' become even more important. Other freight services pay much lower tariffs through the metropolitan system. It would seem fair and equitable that all freight services pay a similar level tariff in the suburban network.

3.4. Train Path Allocation Percentage

3.4.1. General Application

The general approach to determining train path allocation percentages appears reasonable based on the information presented by Queensland Rail. However, it should be noted that the number of contracted train paths for non-coal services is not the only factor that constrains the capacity that can be contracted by coal users. In particular:

- Queensland Rail is legislatively bound to preserve a certain number of paths for non-coal freight services - even if all of these paths are not currently contracted to non-coal freight services, they remain unavailable to coal services;
- We anticipate that, under the Transport Services Contract, the Queensland Government may require that Queensland Rail create or maintain capacity specifically for non-coal freight services. A case in point is the two additional passing loops and tunnel works currently being funded by the Queensland Government to increase the number of non-coal trains. Again, even if all of these paths are not currently contracted to non-coal freight services, this capacity is not going to be available for contracting for coal services.

As a result, New Hope believes that, for the purposes of determining the train path allocation percentages, the paths 'committed' to non-coal freight services should be the greater of:

- Paths contracted for non-coal freight services;
- Paths preserved for use by non-coal freight services; and
- Paths that the Queensland Government otherwise requires be made available to non-coal freight services.

Using this approach, the additional capacity being developed for non-coal services via the Queensland Government's funding of passing loops and tunnel works will lead to a lower share of paths allocated to coal. The Authority will be able to seek information from Queensland Rail on the exact increase in available non-coal freight paths from this investment, but New Hope estimates that this could reduce the percentage of Rosewood to Macalister train paths allocated to coal services to closer to 50%.

3.4.2. Reduction for Brisbane Metropolitan Regional Peak

The approach adopted by Queensland Rail does not fully account for the capacity impacts of the metropolitan peak on the assets from Rosewood to Macalister to Columboola. It neither accounts for the build-up and wind-down of public timetabled services for the peak period nor the non-revenue passenger services being positioned in readiness for the peak or being returned after the peak. The central stabling or parking area for passenger trains in South-east Queensland is at Mayne yard, between Bowen Hills and Windsor. In the early mornings, trains start leaving Mayne at around 4:30 am to provide for the build-up of services in the outer areas of the network. This is because there is

limited stabling or parking of trains in outer areas. After the morning peak, peak capacity trains return to Mayne for stabling by around 10am. Similarly in the afternoon, trains leave Mayne from around 2pm in preparation for the evening peak. At night, trains return to Mayne progressively after the peak.

The actual impact on coal train paths includes the consequential congestion related impacts of trains sitting waiting paths in passing loops. The most significant impacts relate to the Ipswich, Gold Coast and Cleveland Lines due to junction and track occupancy conflicts. The Cleveland line has very limited stabling so it is significantly affected by the build-up and wind-down of peak services and implementation of 15 minute off-peak services early in 2014.

Timetabled peak services build up from 5:23am onwards at Park Road and finish at 9:14 am. At Rosewood morning peak services build up from 4:45 am and continue until 8:05 am. At Corinda Junction, peak services commence building up at 5:20 am and return to normal at 8:58 am. Gold Coast peak is spread between 5:08 am and 09:26 am between Park Road and Yeerongpilly. These times are the public timetable times which would exclude the positioning of non-revenue passenger services from stabling at Mayne as mentioned above.

The ability to run counter peak services is constrained by the build-up of services for the peak direction and subsequent wind-down following the peak. This is due to the major stabling being at Mayne instead of the end of the Cleveland Line for example. While we can argue that coal services are significantly restricted during the 5.5 hour build-up, peak and wind-down period, it is accepted some services still operate albeit in a constrained manner. Consequently, it is estimated that the equivalent real morning peak curfew is reduced from 5.5 hours to close to 4 hours rather than the 2.5 suggested by Queensland Rail.

The afternoon peak is longer due to the spread of hours for school finish and worker finish times. Peak services operate through Corinda between 2:56pm and 6:56pm. Given the build-up and wind-down of services, this period is likely to be around 6 hours. Again, accounting for some limited coal paths in this period, would suggest that there is the equivalent of a peak afternoon/evening curfew of at least 4 hours instead of the 3.5 suggested by Queensland Rail.

Should 8 hours be adopted as the minimum estimate of the "curfew" impact, then:
 $8 \text{ hours unavailability} * 5 \text{ days per week} / 24 \text{ hours} * 7 \text{ days} = 23.81\%$ or rounded up, 24%.

We believe that this 24% loss of capacity is a conservative estimate of the impact of passenger service commitments, as it doesn't account for the increase in timetabled passenger services since the last undertaking. The additional trains are understood to be almost exclusively stabled at Mayne, further impacting the counter-peak and peak directions.

In addition to the capacity losses resulting from passenger peak periods, in recent years, Queensland Rail has implemented a maintenance regime that further erodes the capacity available to coal services. In particular, Queensland Rail has implemented 48 hour weekend closures on segments of the passenger network. This practice has a particularly onerous impact on the capacity availability for coal services, given the reliance on off peak periods (including weekends) to achieve throughput, and the fact that the coal services need to traverse multiple passenger segments, including Ipswich, Gold Coast and Cleveland lines, all of which will be subject to different 48 hour closure periods. This maintenance possession regime is driven primarily by the service standard expectations for passenger services.

Assuming that coal services are prevented from operating due to 48 hour maintenance closures once per month, this creates additional capacity unavailability caused by the metropolitan region as follows:

48 hours unavailability/24 hours * 7 days * 4 weeks = 7.14%, or rounded down, 7%. It is however understood that recent 48 hour closure frequency has been twice per month on the Ipswich/Rosewood Line, once per month on the Cleveland Line and one or two closures per month on the Beenleigh Line. This suggests the 7% estimate is conservative given that any one of three lines having a closure impacts coal services.

In total, the capacity unavailability for coal services from the metropolitan region is conservatively estimated to be in the order of 31%, as compared to Queensland Rail's suggested 15%. Applying this revised estimate of capacity unavailability to a 50% coal path allocation reduces the allocation percentage for pre 1995 assets to 34.5% (rather than the 61.7% and 42.5% allocations proposed by Queensland Rail)

3.4.3. End-User Funded and Coal Specific Capital Expenditure

New Hope accepts that investment incurred specifically for coal services (whether Queensland Rail or user funded) be fully allocated to coal services. Similarly, investment incurred specifically for non-coal services (e.g. the Queensland Government funded investment in new passing loops and tunnel works) should be fully allocated to those other services.

It would also seem equitable that any user funded infrastructure receives a return equivalent to that achieved by Queensland Rail.

3.4.4. Summary of Coal Train Path Allocation Percentages.

As discussed above, New Hope considers that the train path allocation percentages should be adjusted to reflect:

- the impact of capacity enhancements for non-coal freight on the % of paths allocated to coal services; and
- a more robust estimate of the capacity losses arising from the curfews/restrictions on entry to the Brisbane Metropolitan Region driven by passenger service requirements.

4. Building Blocks

This section provides comments on Section 4 of Queensland Rail's submission, adopting the same numbering and headings.

4.1. Opening Asset Value

4.1.1. Appropriateness of DORC Valuation

We have no 'in principle' objection to DORC methodology; however we note that it is not a precise methodology because there is considerable scope for judgement to be exercised. In this context, we believe that there are significant flaws in the way that the DORC methodology has been applied to the valuation of the Western System assets, which result in the valuation being excessively high, considering the poor condition of the assets, together with the severe constraints on efficient above rail service delivery caused by inadequate below rail service standards.

Impact of actual asset condition

We note that the asset valuation undertaken by Everything Infrastructure for the Authority's 2009 Decision valued the asset on a modern engineering equivalent basis – which is assumed to be 50kg rail on concrete sleepers. This is a standard valuation approach, and we do not object to valuations being based on a modern engineering equivalent.

However, to the extent that the actual condition of the asset is less than the standard assumed in the valuation, and that this will cause additional costs in the future as compared to what would have been assumed for the asset being valued, we believe that a condition based deduction to the asset value should be made. This is fully consistent with the approach that was adopted by the Authority in relation to QR Network's initial DORC valuation for its first access undertaking in 2001. In this case, the Authority concluded that the condition of the Goonyella system ballast was poorer than would typically be expected for the valued asset, and therefore a condition based deduction to the asset value was made. The amount of this deduction reflected the additional expense forecast to be incurred over a ten year period as a result of the excessive ballast fouling.

This philosophy was again confirmed by the Authority in QR Network's 2010 access undertaking, where allowable revenues were adjusted downwards to reflect the poor condition of QR Network's ballast.

In the context of Queensland Rail's Western System, we believe that the actual condition of the infrastructure requires far greater ongoing capital and maintenance expenditure than would be the case for a railway of the type and age assumed in the valuation. For example:

- The Western System Asset Replacement Project is, as previously identified by Everything Infrastructure and accepted by the Authority, simply contributing towards bringing the infrastructure up to the standard assumed in the asset valuation;
- We believe that this is also likely to be the case with a number of other forecast capital projects, particularly those involving relaying sections of track with concrete sleepers and 50kg rail.

In addition, the maintenance regime required given the actual standard and condition of the track, in particular the extent of timber sleepers and bridges, far exceeds that which would be the case if the track was actually constructed at the standard assumed in the valuation, even accounting for the assumptions on age.

We believe that the Authority should consider whether deductions to the DORC valuation are appropriate to reflect the actual condition and required maintenance regime for the Western System assets, as compared to that assumed in the valuation.

Inadequate Service Standards

New Hope believes that the Authority need also consider whether the poor performance standards of the Western System should lead to either to further optimisation or depreciation of assets as part of the DORC valuation.

The appropriate scope of optimisation was first considered by the Authority in the valuation of QR Network's central Queensland rail infrastructure for the 2001 access undertaking. At this time, the Authority considered whether it should reduce the opening asset value to reflect the additional costs imposed on operators due to the narrow gauge construction standard. While the Authority ultimately

chose not to adopt this approach in that instance, New Hope considers that the issues are far starker in the Western System and there is merit in reviewing whether the asset value should be optimised to reflect the inefficient costs imposed on above rail operators due to poor system design, particularly low axle load and limited train lengths.

An alternate approach would be to reflect, in the assumed depreciation of the assets, that the infrastructure is close to being technically obsolete. This would likely result in the assets being considered to be close to life expired, resulting in a depreciation estimate far greater than 50% of the Optimised Replacement Cost.

As discussed in Section 2.2.3, the inadequate infrastructure standard of the Western System places severe constraints on the operation of an efficient above rail service. It is inconceivable to New Hope that these impacts would be considered irrelevant in the valuation of those infrastructure assets.

4.1.2 Tunnel Allocation Adjustment

There is no transparency provided on the valuation by "Everything Infrastructure" of the tunnels. Given the tunnels are over 100 years old, technologically obsolete, limit vehicle size etc., it is difficult to understand how such a high value of \$85.9m was determined.

It is accepted that errors in allocation of assets need to be addressed.

4.1.2. Western System Asset Replacement Project Reduction

Consistent with the discussion in 4.1.1 above, we believe that the Authority should retain its position from the 2009 Draft Decision that this project simply has the effect of bringing the infrastructure up to the assumed valuation standard, and as such, the full value of this project should be deducted from the opening DORC valuation.

4.1.3. Summary of Opening Asset Value

In the absence of transparent asset value and condition information, it is not possible to provide precise comments on the opening asset value. However, it is New Hope's view that the opening asset value is clearly excessive, given the high ongoing maintenance and asset replacement costs resulting from the actual asset condition being less than that of the 'valued asset', together with the high costs imposed on above rail operators due to the poor service standards provided by the infrastructure.

4.2. Asset Lives and Indexation

4.2.1. Asset Lives

It appears unusual that Queensland Rail intends to include the 'top 600' in an amalgamated 'track' asset with a life of 35 years.

The term top 600 usually is taken to mean the top 600mm of the formation or earthworks. In a modern well-constructed railway, the top 600 is an engineered compacted layer of suitable materials to deliver a high strength capping over lower strength bulk earthworks. In most railways, the top 600 would be considered to form part of the formation (or earthworks) asset. An amalgamated track asset would typically only include rail, sleepers and ballast.

The effect of QR's approach is to substantially shorten the assumed life of the top 600. Generally all earthworks including the top 600 are considered to have a 100 year life.

The 35 year life appears to be more consistent with a heavy haul railway than the West Moreton System. It is proposed that the asset lives should be revisited taking into account the actual infrastructure in place.

4.2.2. Asset Indexation

In the interim, 2.5% seems appropriate for indexation on the basis that it is reviewed and corrected periodically.

4.3. WACC

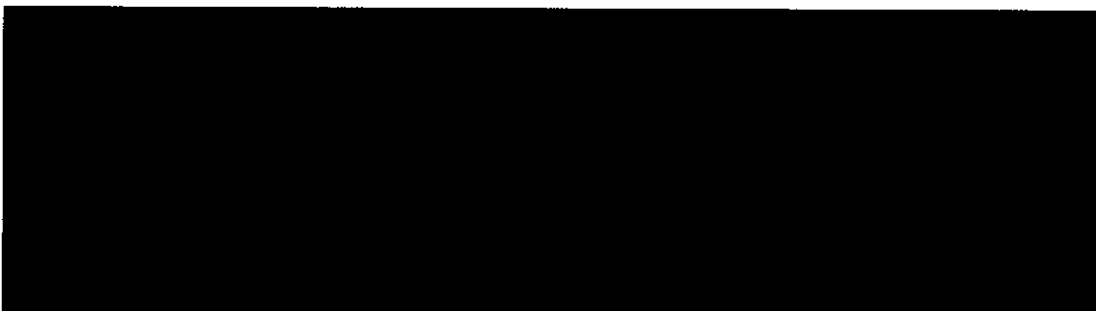
New Hope appreciates that QR has not taken an aggressive approach to determining an appropriate WACC. While this is the case, the WACC still over-compensates QR for its real commercial and regulatory risks. QR has limited downside risk due to take or pay arrangements and limited liability for failure to perform, but has an upside “windfall” if above contract tonnage is hauled. It is noted that QR Network’s first access undertaking in 2001 had a lower asset beta of 0.4 instead of the 0.45 proposed.

New Hope relies on the QCA to assess the reasonableness of the WACC claim for the purposes of establishing a ceiling price. However, where the building block approach results in a ceiling price which is uncompetitive, unreasonable, and unlikely to meet the requirements of the QCA Act, we consider that recovery of a full WACC on the full DORC valuation is not sustainable.

4.4. Volume Forecasts

Actual volumes have exceeded the assumed contract entitlement of 7.5 million tonnes per annum (based on 87 contracted coal paths at 85% availability). This has provided QR with a revenue “windfall” for the 2.63 million tonnes above contract tonnage over the last two years. Paying the same access tariff for above contract railings is not warranted, given that recovery of the fixed costs of service delivery (including fixed operating and maintenance costs and incremental capital investment) is achieved at full contract volumes. Volumes in excess of this, particularly when using ad hoc paths, have a very low incremental cost to Queensland Rail.

Further, from the users’ perspective, above contract railings are ad hoc and not guaranteed, and hence have less value. For example, companies will not sign off on major investments without some guarantee of being able to get the product generated by the investment to market – in this circumstance ad hoc paths have very little value.



Given the absence of a revenue cap for the Western System, options for addressing this are to either:

- Modify the volume forecast to reflect a forecast of actual railings; or

- Adjust the 'ceiling price' to calculate a discount rate for uncontracted paths at a level that reflects the incremental costs associated with providing ad hoc paths, given that fixed costs (including all coal specific investment) are fully recovered through contracted paths.

New Hope believes that the second option is preferred, as this reflects a more efficient pricing structure, and better reflects the differences in value of contracted and ad hoc paths.

4.5. Capital Program

The coal specific capital program of \$76.324m (top of page 17) appears excessive. The Worley Parsons West Moreton Reference Tariff Submission Review (Worley Parsons Report) reviewed 14 projects having a combined cost of \$73.9m. The larger projects only are commented on below:

The Slope Stabilization project (\$7.793m) according to Section 5.2.4 of the Worley Parsons Report is not as yet adequately scoped, consequently the dollar amount is a high level estimate. It could be argued that this is not a coal specific project.

The formation repairs (\$13.25m) are to attend to 5km of the 17.4km identified by QR. It is noted on page 20 of the Worley Parsons Report, that "*some of the plant rates used for Queensland Rail owned plant were considered high in comparison with industry expectations for similar equipment*". It might also be speculated that better work methods might reduce this cost.

Timber Bridge Strengthening and Elimination (\$10.504m) were considered by Worley Parsons to be at the "*higher end of industry average...*" (Section 5.4.4, page 25).

The estimate for Check Rail Curves Toowoomba Range and Little Liverpool Range (\$12.220m) appear to have been made on the experience of attending to one curve only. This amount also seems very high by normal standards.

The Western System Asset Replacement (\$23.581) for Rosewood to Macalister is designed to replace 20.115km of track and 19 turnouts. Unfortunately the unit rates in the Worley Parsons report are not available. In the absence of this information, it is difficult to understand why the costs would exceed \$15m. Rail typically costs less than \$2,000 per tonne to supply or \$100,000 per kilometre of rail (or \$200,000 per kilometre for both rails). Indeed, Section 5.9.4 of the Worley Parsons Reference Tariff Submission Review (page 33) identifies a QR estimate of \$1.937m for 20km of re-railing which is equivalent to \$100,000 per kilometre. New concrete sleepers are expected to cost approximately \$150,000 per km installed. Significant ballast replacement is estimated to be unlikely to cost more than \$100,000 per km. Turnouts including points machines are expected to cost approximately \$250,000 each installed.

In summary, the capital costs are considered to be high by normal standards and in some cases based on preliminary estimates. It is also apparent that some of the works are not solely related to coal trains. New Hope relies on the QCA and its advisers to assess the prudence of scope, prudence of standard and prudence of cost.

4.6. Maintenance Program

Allocation methodology

New Hope has significant concerns with the methodology proposed for allocating maintenance costs to users on the Western System. It appears that Queensland Rail's maintenance cost estimate covers the entire rail section from Rosewood to Miles. Queensland Rail then proposes to allocate these maintenance costs to individual track segments using a gtk allocator.

We do not believe that a gtk allocator is an appropriate method for allocating costs between track segments, and is not always an appropriate means of allocating costs of a track segment between users. The preferred approach would be to identify the forecast costs based on the actual maintenance task required on each track segment, and for many activities, it should be possible for Queensland Rail to do this. However, to the extent that this is not possible, then an allocation approach that is more aligned with the cost drivers should be adopted.

For track maintenance (excluding mechanised resleepering), there are significant fixed costs associated with maintaining a section of track, regardless of the level of use. These include the costs of inspections, time based maintenance activities (which is a particular issue where there are substantial timber sleepers and structures) and some other elements of preventative maintenance work. These fixed costs should be allocated on a \$/track km basis as they relate to the extent of the network being maintained. Beyond this, track maintenance costs will increase with usage, and a gtk allocator is appropriate.

The large forecast expenditure on mechanised resleepering should be allocated on a track km basis, over the segments of track where Queensland Rail intends to do this work.

Allocations for trackside systems should be on a train km basis, as maintenance of components such as signalling and radio infrastructure are independent of train weight. This is consistent with the rail costing convention (called NFG2) agreed by the former National Freight Group of the Australian Railways.

New Hope considers that the net effect of Queensland Rail's allocation approach is to allocate an excessive proportion of the maintenance expenditure to coal services and, as a result, should be rejected by the Authority.

Forecast maintenance costs

Maintenance costs are expected to vary between \$20.7m and \$29.2m per annum over the four years 2013/14 to 2016/17 (Worley Parsons Report, Section 4.1, page 11).

Track maintenance excluding mechanised resleepering is in excess of \$15m per annum. This cost is equivalent to an average of \$50,000 per km. This seems very high for a light axle load network excluding mechanised resleepering. The Australian Competition and Consumer Commission final decision on the Australian Rail Track Corporation's Access Undertaking in 2008 identified QR's then maintenance costs excluding major periodic maintenance were between \$8,920 to \$12,870 per kilometre. The increase to \$50,000 per km is very significant. Such high maintenance figures are inconsistent with the dollar value of the asset base. If maintenance costs are this high, then asset values should be virtually zero. Even for old, fully depreciated infrastructure, the maintenance costs seem high for such a low axle load. It is suspected the drivers for the high maintenance costs are related to inefficient work methods and or poor possession practices.

The mechanised resleepering in 2015/16 and 2016/17 are estimated to be equivalent to \$76,000 per kilometre between Rosewood and Miles. This is equivalent to \$54 per sleeper for every main line sleeper despite only 15% of the timber sleepers are being replaced! Given full replacement with all new low maintenance concrete sleepers are not much more costly (about \$100 per sleeper inserted) this raises questions whether the investment is prudent or optimal. Section 6.3.2 of the Worley Parsons report indicates average QR costs of \$339 to \$352 per sleeper replaced (42,743 sleepers costing \$14,497,000 and 26,629 sleepers replaced for \$9,384,000). While Worley Parsons considers these costs to be within "an expected industry range..." clearly there are significant inefficiencies in this assumption to cause the cost to be triple that normally expected.

It is suspected that QR's practices could benefit from more efficient work methods, e.g. one iron ore railway has a 10 day annual closure which allows highly efficient maintenance activities which would achieve much lower resleepering costs. Plant, equipment and human resources are marshalled for the 10 day annual closure and then reallocated to other parts of the network. This approach facilitates efficient plant and labour utilization.

Maintenance in the last undertaking was forecast at \$57.4 million whilst in this undertaking (p18 of general submission) it is forecast over the 4 years to be \$104.5 million. This represents a massive 82% increase. Given efficient rail organisations consistently improve productivity by around 2% per annum, this increase is difficult to comprehend.

In summary, maintenance costs are considered to be very high and extremely inefficient. QR may wish to consider alternative work methods to reduce these costs to normal levels. The normal level of productivity improvement has not been achieved given the significant 82% increase in costs over the 4 years.

4.7. Other Operating Costs

QR has noted its expenses are inefficient. New Hope does not agree with the "glide" to efficient costs. QR should be incentivised to improve its efficiency by being compensated for efficient costs only from the start of the undertaking.

The corporate overhead allocation is 46.6% of the train operations management and other expenses combined. This is well in excess of normally accepted levels of around 10%, again suggesting significant inefficiencies.

One could also argue the reasonableness of some of the components. Train control costs of \$3,070,000 for approximately 12 paths per day (87 contracted per week), seems excessive. This is equivalent to an average of three to four coal paths being controlled per control shift. This would seem a very comfortable workload for one controller. If we assumed 6 people are required to operate one control board continuously and the full employment cost per controller was \$150,000 per annum, then control costs would be around \$0.9m per annum. If 10% were added for control supervision, the control cost would be approximately \$1m per annum. It is unclear how costs could be three times our estimate given plant and software is separately identified.

In summary, other operating costs appear to be several orders of magnitude higher than what would be expected and hence are assumed to be very inefficient and absent of normal productivity improvement.

5. Conclusions

New Hope Coal strongly objects to the Queensland Rail proposed reference tariff. The proposed Western System tariff is more than double the next most expensive benchmarked access charge and worse still, for a very poor access service offering. The access offering permits only small, low axle load trains to operate in a constrained manner due to the absolute priority of passenger trains. The poor service offering discourages above rail competition as the incumbent operator has a unique advantage in terms of availability of low axle load rollingstock.

The high access charge and excessive escalation has impacted the competitiveness of Western System Coal producers. Rather than achieving productivity improvements, Queensland Rail proposes to increase maintenance costs by a massive 82%. The proposed capital program also seems to have high unit costs and the scope is not solely for coal train services. Very high proposed investment levels and very high maintenance costs are inconsistent with the inferior access service offering.

We suggest that the proposed tariff should not be approved, having regard to the criteria set out in section 138 of the QCA Act, because:

- The resulting tariff would not be consistent with the object of Part 5 of the QCA Act as it would not promote the economically efficient use of the infrastructure with the effect of promoting effective competition in downstream markets. Impacts which would be inconsistent with the object of Part 5 would include:
 - The proposed tariffs will place coal producers in this region in an uncompetitive position, which will impact negatively on competition in coal markets (New Hope estimates it is disadvantaged by between \$8/tonne and \$20/tonne).
 - The high tariffs will discourage further investment in this system. In fact, utilisation of existing infrastructure will be likely to decline over time, as mines become more uncompetitive due to high rail costs, thereby preventing economically efficient use of the infrastructure
 - Low volumes combined with poor below rail service standards will continue to limit the feasibility of above rail competition.
- The proposed tariff is not in the public interest, including:
 - the public interest in having competition in markets including above rail which is affected by the low infrastructure standards and service offering.
 - the public interest in promoting economic activity, avoiding job losses, creating additional jobs, maintaining and increasing royalties, and maintaining and increasing taxes paid by mining companies, all of which rely on the ability to access internationally competitive coal supply chains.
- The interests of persons who may seek access to the service would be severely adversely affected. Mining companies, as potential access seekers, would face higher costs, reduced profitability,

reduced competitiveness and the potential loss of expansion opportunities due to competitiveness of projects.

- The proposed tariff does not reflect any reasonable assessment of the applicable 'reference transaction', that is, the shared expectation of how prices would change over time that existed prior to the parties investing in sunk mine and rail infrastructure investment.
- The proposed tariff does not promote an effective infrastructure development decisions nor does it reflect desired levels of productivity improvement.

We note the pricing principles in section 168A of the QCA Act, particularly the principle that the price of access should generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved. In this case, a key question is the value of the "investment" on which a return should be allowed. While we agree that it is appropriate for Queensland Rail to earn a return on investments made for the purpose of providing access to coal services, we do not believe that this should guarantee a return on the DORC valuation of pre-existing assets, particularly where those assets had previously been valued at a scrap valuation. The extent to which Queensland Rail should be able to recover this DORC valuation should depend on a broader range of factors; including the overall competitiveness of the Western System supply chain and consideration of the applicable 'reference transaction'.

In conclusion, rail costs have a significant negative impact on New Hope's competitiveness. Without a competitive access tariff the future of coal mining along the Western System must be called into question.

Yours faithfully,
NEW HOPE GROUP



SHANE STEPHAN
Chief Financial Officer

Attachment A

Indicative Operator and Access Benchmarks



New Hope Corporation Limited

ABN 38 010 653 844

Contact

Phone: +61 7 3418 0500

Fax: +61 7 3418 0355

Our Ref:

Your Ref:



3 May 2013

Queensland Rail's 2013 Draft Access Undertaking

New Hope Corporation submission

Thank you for the opportunity to provide this submission on Queensland Rail's Draft Access Undertaking of February 2013.

New Hope is the largest coal producer in Queensland Rail's West Moreton System. In addition, New Hope is developing the Colton project, which will rail coal to Gladstone using rail infrastructure which is predominantly managed by Queensland Rail. New Hope is pursuing growth opportunities across its portfolio and seeks regulatory arrangements which promote efficient supply chain performance, reasonable and predictable charges for use of the infrastructure, and a practical pathway to expansion.

New Hope notes that the draft undertaking proposes a relatively 'light handed' regulatory arrangement, with substantial discretions available to QR in a range of key areas. New Hope considers that this is generally acceptable, subject to reasonable protections, for the term of UT1, and should be reassessed for UT2 taking into account the extent to which QR has applied these discretions on a reasonable basis.

The comments provided in this document are additional to those set out in our submission of 12th of April.

Our further comments on the Draft Access Undertaking are provided below:

Part 1: Application and Scope

- 1.4: Extensions:

QR proposes an investment framework in which QR will have no obligation to invest in the network (1.4.1(a)(ii)) and will face no limitations on the terms sought from expanding customers in return for QR offering to finance expansions. New Hope is prepared to accept a relatively 'light handed' regulatory arrangement for QR for the period of the first undertaking, and will seek more prescriptive arrangements in the event that this flexibility is used inappropriately, however, we do consider that there is a need, in UT1, for greater clarity regarding QR's obligation of offer a 'user funding'

130503 - QR ACCESS UNDERTAKING SUBMISSION DOCX

Registered Office: 3/22 Magnolia Drive, Brookwater, Queensland 4300
Postal Address: PO Box 47, Ipswich, Queensland 4305 Australia
Website: www.newhopecoal.com.au



option. This option must represent a credible alternative to QR funding. In particular, the requirements to be met before QR will be obliged to construct an extension using user funding are unreasonable, and include:

- 1.4.1(a)(iii)(A): The Access Seeker agrees to provide funding 'in advance' to QR on terms and conditions 'satisfactory' to QR. We consider that funding should be provided progressively as QR makes financial commitments to the project, and that financial security should be provided (rather than cash) in respect of commitments which will not result in a cash outflow within the coming 1-2 months. In addition, we suggest that QR should be required to act reasonably when assessing whether it is 'satisfied' with the terms and conditions. The requirement to act reasonably applies when QR is considering its 'legitimate business interests' (1.4.1(a)(vii)(F)) and the same standard should apply.
- 1.4.1(a)(iv): The requirement that QR bears '*no cost or risk in relation to constructing, owning, operating and managing the extension*' is unlikely to ever be achievable. QR will be the operator and manager of most extensions, and will incur costs and receive revenue for this role. QR will also bear some (limited) risks under the terms of Access Agreements which use the relevant infrastructure (and will be compensated for doing so). We do accept that QR should not be required to bear any material, uncompensated cost or risk in relation to such an extension. This section should be revised, or alternatively deleted given that the principle is adequately dealt with in 1.4.1(a)(vii), which specifies that the extension not '*adversely affect QR's legitimate business interests*'.
- 1.4.1(a)(vii): While we are generally comfortable with this section following the insertion of a reasonableness test, we consider the test in part F (that the project does not adversely affect QR's legitimate business interests) should be clarified to ensure that the loss by QR of the opportunity to seek Access Conditions cannot be deemed to adversely affect QR's legitimate business interests. That is, the test of an adverse effect should be that QR is no worse off than had the project not been undertaken, rather than no worse off than had the Access Conditions been accepted.
- 1.4.1(a)(vii): We do not consider that it is necessary, in all cases, that Access Agreements be in place for all of the Additional Capacity. For example, if a user funds a project which creates a level of uncontracted capacity, but QR is not worse off as a result of this situation (eg. because the volume forecasts upon which reference tariffs are based exclude the spare capacity or because rebates to the user-funder are limited to the contracted tonnes), then the requirement in this section is not an appropriate basis on which QR should refuse to undertake the project. Also, the requirement that Access Agreements '*have been executed*

on terms and conditions satisfactory to QR should be amended – if Access Agreements have been executed, the question of whether these were on terms satisfactory to QR is not relevant.

We have similar concerns with the drafting regarding Funding Agreements, including:

- 1.4.2(e): The test of 'no cost or risk' is unlikely to be practical, for the reasons set out above, and makes all of QR's remaining obligations in this section meaningless. Again, we accept the principle that QR must be reasonably compensated for any cost or risk which it bears.
- 1.4.3: The principle stated in part (a) regarding rebates is reasonable. Unfortunately the more detailed drafting in part (b) cuts across this principle and this will not be appropriate in all cases. For example, the effect of 1.4.3(b)(i) is that no rebate will apply, despite a user-funded asset going into a RAB and resulting in a return on and of capital to QR, if another user uses the extension but did not need the extension – even if that user is paying Access Charges which include elements of cost relating to the user-funded assets. Also, the requirement that QR not be 'adversely affected' requires redrafting, as paying a rebate will always 'adversely affect' QR, when compared to the alternative of retaining this revenue. We understand that this is not the intention.
- 1.4.4: The words in the last line of this paragraph after the word "agreed" do not, in our opinion, clearly state what we believe to be QR's intention; that it have the right to appoint another operator to any potential extension. This right should only occur in the circumstance that QR appoint another operator for the entire line to which the extension is a part.

Part 3: Pricing Principles

New Hope relies on the QCA to assess the reasonableness of the pricing principles proposed by QR.

Part 4: Network Management Principles and Operating Requirements Manual

Section 4.2 is about the process for making changes to the Operating Requirement Manual ("ORM"). New Hope will separately provide comments on the current draft of the ORM. In regard to Part 4:

- The requirements to consult (4.2.2(c) to 4.2.2(e)) are not particularly onerous on QR, and do not result (regardless of the result of the consultation) in QR being prevented from implementing any amendment to the ORM. Despite this, these requirements do not apply when the ORM is being amended on safety grounds or in response to a Material Change. We accept that there may be a need to amend the ORM urgently in some limited cases, most likely relating to safety or a change in law, but we do not

consider that a Material Change which is an Impost Change or a Change to Credit is likely to require an urgent amendment to the ORM. A preferred approach is that:

- Where practical (in QR's reasonable opinion and taking into account the urgency of the change to the ORM), the consultation will occur prior to implementation.
 - In all other cases, the consultation will still occur, but QR may implement the change immediately on an interim basis, then consult.
- There is no requirement that QR act reasonably when amending the ORM, other than in the case where the change Unfairly Differentiates. This requirement should be inserted. Where QR considers that a change to the ORM must be made urgently, then the change could be made on an interim basis, however there should still be a right to dispute the change and the criteria should not be limited to unfair differentiation, nor be limited to the consideration of the impacts on the Access Holder, as changes to the ORM may also have significant impacts on the Customer of the Access Holder. Any change to the ORM which has a material negative impact on an Access Holder or its Customers should be capable of being disputed to assess whether the change and the negative impact were reasonable.
 - The protections against unfair differentiation (4.2.3) do not apply in the cases listed in 4.2.3(a)(i)(ii) or (iii). It is not clear to us why, in these cases, QR needs to be able to differentiate unfairly. For example, where there is a change in any tax, this by definition is a Material Change (regardless of the materiality of the change) and this then provides QR with a right to amend the ORM free of any of the provisions relating to unfair differentiation.
 - The definition of Unfair Differentiation is only satisfied if the change to the ORM "unfairly differentiates" and has a "material adverse effect on the ability of one or more of the Access Holders to compete with other Access Holders". We do not consider that the second test is appropriate. For example, if a case of unfair differentiation impacts on the ability of an operator to service a particular mine (or on the cost), the second test may not be met even if the first test is satisfied. We would suggest that an action should meet the definition if the action "unfairly differentiates and has a material adverse impact on the Access Holder or its Customer".
 - Changes to documents prepared by QR which are referred to in the ORM should be subject to the same consultation and dispute resolution requirements as apply to changes to the ORM itself.

Part 7

- WACC: The definition of WACC which applies after the approval date locks in a defined Margin, and may therefore differ from the WACC which is approved by the QCA in any later pricing decisions (for example, in the setting of reference tariffs for the

West Moreton System). We suggest that, in respect of the West Moreton System, WACC should mean the rate approved by the QCA in its most recent pricing decision from time to time.

Schedule C: Access Agreement Principles

- **Clause 9** allows QR to pass on costs relating to noise mitigation measures on the network. In the case of the West Moreton System, we would expect that these costs are reflected in the building block components (as capital or operating expenses) and are therefore recovered through reference tariffs.
- **Clause 19.2** requires that an Access Agreement provides for Relinquishment Fees equal to the present value of take or pay charges for the period of relinquishment. New Hope considers that, to the extent that QR collects any Relinquishment Fees, this should be taken into account in setting future tariffs. Where tariffs are derived by reference to a building block methodology (as we expect will occur for the West Moreton System), relinquishment fees should either be deducted from the allowable revenue in the regulatory period following collection, or should be deducted from the RAB. Without such an adjustment, Relinquishment Fees represent a windfall gain for QR.
- **Clause 20: Assignment.** This clause provides that QR may assign an Access Agreement without the consent of the Access Holder, while the Access Holder may assign only with the consent of QR. New Hope suggests that this should be amended to restore some balance, as follows:
 - o QR's right to assign without consent should apply only where the assignment is to a party which is to become the owner/manager of the relevant railway infrastructure.
 - o An Access Holder's right to assign should be subject to consent by QR, but with consent not to be unreasonably withheld.

Comments on Standard Access Agreement:

Clause 5

- 5.1(a) provides that QR will '*maintain the Network in a condition such that the Operator can operate Train Services in accordance with this agreement*'. Given the many limitations which may apply to the rights of the Access Holder to operate Train Services, this maintenance obligation is insufficient. New Hope suggests that, at a minimum, QR should be required to maintain the Network to a prudent standard taking into account the contracted Train Services.
- 5.1(b): QR should be required to use reasonable endeavours to provide notice prior to undertaking Rail Infrastructure Operations.

- 5.1(c): QR should be required to use reasonable endeavours to obtain indemnities from parties carrying out Third Party Works for costs, expenses, losses or damages incurred by Operators in relation to the works, and should pass the benefit of claims under such indemnities to the Operator where available.

Clause 6

- 6.2(b)(v): The requirement "not to cause or allow any rubbish, substance or thing to be deposited or released on or about the Network" is problematic when read in the context of coal and coal dust. The requirement set out in the draft Undertaking (Schedule A, 2.1(c)(xiv)) is more reasonable and achievable: i.e. *"utilise measures to minimise coal spillage and/or leakage en route that are reasonable, having regard to practices existing at the Approval Date"*.
- 6.8: We refer to our comments on part 4 of the Undertaking.

Clause 11

The complete exclusion of liability in relation to the matters listed in 11.2 is unreasonable. For example, it would appear from the drafting that QR will not be liable if any "thing carried by a train service" is lost regardless of the nature of QR's contribution to this event. This would include, for example, where QR was negligent, grossly negligent, or in breach of an agreement including where QR wilfully breached an agreement.

New Hope also has more general concerns regarding the proposed risk allocations reflected in Clause 11. Substantial changes are proposed to indemnities, claim thresholds and exclusions compared to the provisions of the existing standard Access Agreement. New Hope considers that the previous provisions and risk allocation remain appropriate. These provisions have been reviewed by the Authority and approved following previous consultation, and New Hope does not consider that there is a need to amend the approach under the new Undertaking.

Conclusion:

Thank you for your consideration of this submission.

Please contact Mr Sam Fisher on [REDACTED] if you would like to discuss any of the matters raised in the submission or in regard to the Draft Undertaking generally.

Yours faithfully

NEW HOPE CORPORATION LIMITED

[REDACTED]
Shane Stephan
Chief Financial Officer

New Hope Corporation Limited

ABN 38 010 653 844

Contact

Phone: +61 7 3418 0500

Fax: +61 7 3418 0355

Our Ref:
Your Ref:



NEW HOPE SUBMISSION TO QCA QUEENSLAND RAIL'S 2013 DRAFT ACCESS UNDERTAKING NEW HOPE CORPORATION SUBMISSION

Thank you for the opportunity to provide this submission on Queensland Rail's Draft Access Undertaking of February 2013.

New Hope notes that the Authority has extended the date for submissions regarding certain matters to 3rd May 2013, and intends to facilitate a series of forums on these matters over the coming weeks. These matters include:

- (a) Above-rail operational issues;
- (b) Western System pricing;
- (c) Aspects of the proposed standard access agreement;
- (d) Mount Isa pricing; and
- (e) Investment framework matters.

New Hope welcomes this approach.

In providing this submission regarding matters not listed above, we note the linkages between various issues and that consultation regarding the deferred matters may raise further issues in regard to the matters discussed in this submission.

Our initial comments on the Draft Access Undertaking are provided below:

Part 1: Application and Scope

- 1.1: Duration

New Hope considers, as was set out in our July 2012 submission, that the term of the undertaking should be no more than four years from 1 July 2013 (or slightly longer than four years if approved prior to 1 July 2013). That is, the expiry date should be 30 June 2017. This is based on the fact that the draft undertaking proposes a light-handed approach to regulation, and that QR's approach to applying the undertaking is untested.

DOCUMENT1

Registered Office:
Postal Address:

3/22 Magnolia Drive, Brookwater, Queensland 4300
PO Box 47, Ipswich, Queensland 4305 Australia
Website: www.newhopecoal.com.au



- 1.4: Extensions: We assume that this is to be dealt with under the "Investment Framework" consultation.

Part 2: Negotiation Process

- 2.7.2 Access Seekers competing for Access Rights

New Hope continues to have strong concerns regarding the process for allocating capacity between competing Access Applications. New Hope's July 2012 submission stated:

"The process for allocating additional capacity should be clear and equitable and the ability to allocate capacity based on QR's commercial interests should be subject to certain limitations. In particular, where competing access applications both involve coal-carrying train services which would pay reference tariffs or tariffs derived from reference tariffs, the revenue arising from different origins/destinations should not be a differentiating factor (ie. clause 2.7.2(iv)(A) and (B) should not apply). This is because the process of considering QR's commercial interests should take place during the setting of reference tariffs. It is not appropriate to discriminate against a particular mine on the basis that the tariff proposed by QR and approved by the QCA is considered less attractive by QR than the approved tariff for another origin/destination. Instead, competing applications should be assessed based on the extent to which each applicant is ready and able to use the paths sought (i.e. has the necessary production capacity, approvals and network exit capability). In the event that two Access Seekers are equally "ready and able", would both pay tariffs based on reference tariffs, and are not materially differentiated based on contract term or credit risk, then we would expect that the first of these parties to apply for access should be the first to be allocated capacity."

QR's latest Draft Access Undertaking continues to propose a test based on "*how favourable an Access Agreement is likely to be to Queensland Rail as assessed by Queensland Rail in its absolute discretion*". Given this right, it appears that QR would not be obliged to apply the criteria set out in 2.7.2(b).

New Hope considers that some level of transparency and certainty is required in regard to capacity allocation, and that the proposed level of discretion for QR is not appropriate. We therefore consider that competing "ready and able" Access Applications which would pay reference tariffs should be prioritised based on the date of Access Applications, unless one Access Application is materially differentiated in terms of risk to QR.

- 2.7.3 Renewals

This clause appears to seek to create a renewal right in respect of Train Services for

which there is an applicable Reference Tariff. A renewal right for Train Services involving coal haulage is important due to the long term nature of mining investments. We consider that this clause should be amended:

- To include a process under which QR notifies the Access Holder of the need (and right) to renew, a reasonable period ahead of the expiry of this right. This is, it should not be necessary that a competing application exist in order to trigger a notification to the Access Holder. As currently drafted, it appears that the renewal right will be lost if there is no competing application received more than 2 years ahead of the expiry of the existing Access Rights. It would not seem to be an onerous requirement for QR to notify Access Holders and their Customers before such a critical right is lost (as Aurizon Network is required to do).
 - To provide a renewal right for coal-carrying train services operating under a negotiated access charge, such as Colton (ie. the current drafting would not provide a renewal right because there is no applicable Reference Tariff).
 - To clarify the intent of item (e). While it is accepted that a Renewal Access Seeker must satisfy the normal requirements for gaining access and must enter into an Access Agreement based on the standard terms at the relevant time, this clause as drafted seems to go further. This is particularly a concern when this clause is read in conjunction with Clause 2.7.4, which states that QR is not obliged to enter into an Access Agreement if the network does not have sufficient Available Capacity. We do not consider that this clause should apply to Renewal Applications. This is, an Access Holder should retain the right to renew despite any shortage of Available Capacity (which may have arisen from a loss of system capacity or over-contracting by QR).
- 2.8 New Standard Access Agreements

This clause allows the QCA to give QR a notice requiring QR to submit a proposed standard access agreement for a specified type of Train Service not covered by a Standard Access Agreement. New Hope considers that the clause should be widened to allow the QCA to require QR to submit a proposed form of access agreement in which the rights and obligations of above-rail operators are separated from those relating to capacity and payment obligations (end-user access agreement). While New Hope does not see an immediate need for this form of agreement, and understands that there are potential efficiencies in deferring this issue until an end-user agreement is approved for Central Queensland, we consider that the QCA should reserve the right to request this during the term of UT1 if required.

Part 3: Pricing Principles

We assume that consultation on this section, in regard to the Western System, will occur as part of the deferred process (i.e. as part of "Western System Pricing").

Part 4: Network Management Principles and Operating Requirements Manual

We assume that consultation on this section will occur as part of the deferred process (i.e. as part of "Above Rail Operational Issues").

Parts 5, 6 and 7

No comments at this stage.

Schedule A: Deferred as part of "Western System Pricing" and "Standard Access Agreements".

Schedule B: Deferred as part of "Above Rail Operational Issues".

Schedule C: Deferred as part of "Standard Access Agreements".

Schedule D: Feedback form for Unsuccessful Access Application:

New Hope considers that the proposed feedback form will provide insufficient information in regard to the cause of an Access Application being unsuccessful. A detailed explanation (subject to confidentiality constraints) should be provided, rather than a ticked box, because detailed information would:

- Allow the Access Seeker to seek to address the cause of rejection in a future application.
- Provide some transparency and assurance that the Access Undertaking has been followed.

In addition, Access Seekers should be able to request that similar information, but including confidential information, be provided to the QCA.

Other matters not dealt with in draft undertaking:

New Hope has previously submitted that the Undertaking should recognise the role of the Access Holder's (and Access Seeker's) customer. In respect of coal carrying train services, Access Rights are generally held by train operators for use by specific customers (mines). The undertaking should recognise the interests of these customers, and the undertaking and Standard Access Agreement should provide specific rights for customers. QR has addressed this in the current draft in regard to renewal rights, however, New Hope continues to seek further changes in regard to the rights of the customer:

- A requirement that each Access Agreement entered into for coal carrying train services note the identity of the customer would assist in ensuring that any provisions which seek to provide a right to customers (such as the renewal right) are effective.
- Requirement that transfers of Access Rights to a different origin/destination cannot proceed without the consent of the customer.
- A right for the customer, without the consent of the Access Holder, to trigger a transfer of Access Rights to an alternative Access Holder (for example, if the customer is changing above-rail operators or wishes to hold the Access Rights itself).
- A right for the customer (ahead of any other Access Seeker), to enter into a new Access Agreement (including through a new operator) in circumstances where an Access Agreement is terminated by QR due to default by the operator or is terminated by the operator due to default by QR (replacement Access Agreement).

Yours faithfully,

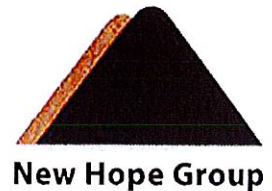
NEW HOPE CORPORATION LIMITED



Shane Stephan
Chief Financial Officer

New Hope Group

A Division of NEW HOPE CORPORATION LIMITED



Contact

Mr Gavan Clarke

Ph: 07 3108 3661

Fax: 07 3108 3761

Email: gclarke@newhopecoal.com.au

Website: www.newhopecoal.com.au

14 September 2012

Queensland Rail's 2012 Draft Access Undertaking New Hope Corporation submission

Thank-you for the opportunity to comment on the submissions made by stakeholders in regard to Queensland Rail's 2012 Draft Access Undertaking. New Hope has reviewed the draft submissions, a number of which reflect similar views to those of New Hope. Our key issues remain as follows:

- A transparent, repeatable methodology for the development of reference tariffs should be developed as soon as possible.
- The existing tariff structure (i.e. a 'per path' plus a 'per gtk' element) is appropriate and this structure should be retained in the reference tariffs to be proposed by QR in 2013.
- The process for allocating additional capacity should be clear and equitable. Given that stakeholders have proposed a number of mechanisms for addressing this issue, New Hope's views are set out in more detail below.
- The terms on which users may fund expansions of the network should be set out in more detail in the undertaking.
- The proposed provisions in regard to renewal rights require improvement and should extend to coal services operating under a negotiated access charge where there is no reference tariff.
- Certain rights should be provided under the undertaking and standard access agreements to recognise the interests of coal producers as customers, where Access Rights are held by an operator.

DOCUMENT1 COMPATIBILITY MODE

Registered Office: 3/22 Magnolia Drive, Brookwater, Queensland 4300
Postal Address: PO Box 47, Ipswich, Queensland 4305 Australia
Website: www.newhopecoal.com.au



- The provisions relating to the forced reduction (resumption) of access rights require refinement. New Hope believes that the interests of Access Holders and their customers must be protected, particularly in the case of short term reductions in demand, but that the 'hoarding' of train paths over an extended period should also be prevented so that paths not required can be made available for long term contracting. This is particularly important in regard to the Western System, given the challenges involved in creating new train paths to meet long term demand in this system.

New Hope's rationale and detailed proposals in regard to these matters were set out in our submission of 13 July 2012 and need not be repeated.

However, due to the range of suggestions provided by stakeholders on the issue of capacity allocation, we do wish to provide further comments on this point.

Stakeholder submissions reflected the common theme that, while QR's commercial interests are a relevant consideration in capacity allocation, adopting this as the primary basis for allocation is unlikely to be equitable. New Hope proposed that:

- the ability to allocate capacity based on QR's commercial interests should be subject to certain limitations.
- where competing access applications both involve coal-carrying train services which would pay reference tariffs or tariffs derived from reference tariffs, the revenue arising from different origins/destinations should not be a differentiating factor (i.e. clause 2.7.2(iv)(A) and (B) should not apply). This is because the process of considering QR's commercial interests should take place during the setting of reference tariffs. It is not appropriate to discriminate against a particular mine on the basis that the tariff proposed by QR and approved by the QCA is considered less attractive by QR than the approved tariff for another origin/destination.
- Where competing applications for coal-carrying services would both pay a reference tariff, the primary consideration for capacity allocation should be the extent to which each applicant is ready and able to use the paths sought (i.e. has the necessary production capacity, approvals and network exit capability).
- In the event that two Access Seekers are equally "ready and able", would both pay tariffs based on reference tariffs, and are not materially differentiated based on contract term or credit risk, then the dates of the Access Applications may be considered relevant.

New Hope does not consider that the date of Access Applications should be a primary consideration in capacity allocation, as may occur in a formal queuing process. This form of approach inevitably leads to the submission of large numbers of Access Applications which represent claims on queue positions (which are, in effect, free options) rather than genuine demand for train paths.

We also do not consider that it is appropriate (as proposed in one submission) that receipt of an Access Application should trigger a process in which QR seeks further applications from other potential Access Seekers. While we would have no objection to such a process where there is spare capacity

beyond the needs of the initial Access Seeker (either existing or arising from the smallest efficient expansion), this is unlikely to be the case in the Western System, where achieving any increment of expansion is extremely challenging. The proposed process in these circumstances is likely to result in dispute and delay, as the various parties seek to secure the limited available capacity and as QR seeks to verify the 'ready and able' credentials of numerous access seekers. We would question the benefits of such a process as it seems highly unlikely to us that a party which is both a genuine access seeker and is "ready and able" (i.e. has production capacity, approvals and port capacity) would wait for an invitation before seeking Access Rights.

Thank-you for the opportunity to provide this further submission.

Yours Faithfully,
NEW HOPE GROUP



Gavan Clarke
Manager Coal Logistics

New Hope Group

A Division of NEW HOPE CORPORATION LIMITED
ABN 38 010 653 844

17 JUL 2012

DATE RECEIVED



New Hope Group

Contact

Direct Phone: +61 7 3418 0572
Direct Fax: +61 7 34180 372
Email: gclarke@newhopecoal.com.au
Website: www.newhopecoal.com.au

13 July 2012

Queensland Competition Authority
Level 19, 12 Creek Street
Brisbane, Queensland
Australia 4000

Attention Mr John Hall

Dear John

Queensland Rail's 2012 Draft Access Undertaking New Hope Corporation submission

Thank-you for the opportunity to provide this submission on Queensland Rail's 2012 Draft Access Undertaking.

New Hope is the largest coal producer in Queensland Rail's West Moreton System. In addition, New Hope is developing the Colton project, which will rail coal to Gladstone using rail infrastructure which is predominantly managed by Queensland Rail. New Hope is pursuing growth opportunities across its portfolio and seeks regulatory arrangements which promote efficient supply chain performance, reasonable and predictable charges for use of the infrastructure, and a practical pathway to expansion.

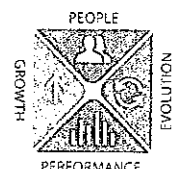
New Hope notes that the draft undertaking proposes a relatively 'light handed' regulatory arrangement, with substantial discretions available to QR in a range of key areas. New Hope considers that this is acceptable for the term of UT1, and should be reassessed for UT2 taking into account the extent to which QR has applied these discretions on a reasonable basis.

New Hope has participated in the development of the Queensland Resources Council's submission on the QR draft undertaking and, subject to the specific comments set out below, supports the QRC submission.

GAVANS LETTER.DOC

Registered Office:
Postal Address:

3/22 Magnolia Drive, Brookwater, Queensland 4300
PO Box 47, Ipswich, Queensland 4305 Australia
Website: www.newhopecoal.com.au



- **Term of undertaking:** Given that the draft undertaking proposes a light-handed approach to regulation, and that QR's approach to applying the undertaking is untested, New Hope considers that the term of this undertaking should be limited to four years. However, we understand that a 30 June expiry date is preferred and therefore would support a term of up to 4.5 years (to 30 June 2017) if the undertaking becomes effective later than 1 January 2012, or a term of up to 3.5 years (to 30 June 2016) if the undertaking becomes effective during 2012.
- **Tariffs:**
 - QR should seek to develop and put in place a transparent, repeatable methodology for the development of reference tariffs as soon as possible. New Hope considers that July 1 2013 is a reasonable date for the revised tariffs to take effect. In order to achieve this, QR should commit to submit (or be deemed to have submitted) its proposed reference tariffs no later than 31 March 2013. Clearly the currently proposed commitment, to submit reference tariffs for approval by as late as 30 June 2013, is not consistent with approval by 1 July 2013. New Hope accepts the extension of current tariffs in the interim period.
 - New Hope considers that the existing tariff structure (ie. a 'per path' plus a 'per gtk' element) is appropriate and that this structure should be retained in the reference tariffs to be proposed by QR in 2013.
 - New Hope considers that the form of regulation should provide appropriate incentives to QR without allowing QR to retain an unreasonably level of benefit where tonnages substantially exceed the levels on which reference tariffs are based. A 'price cap' arrangement with mid-term review mechanisms is therefore preferred over a revenue cap form of regulation.
- **Capacity Allocation and Queuing:** The process for allocating additional capacity should be clear and equitable and the ability to allocate capacity based on QR's commercial interests should be subject to certain limitations. In particular, where competing access applications both involve coal-carrying train services which would pay reference tariffs or tariffs derived from reference tariffs, the revenue arising from different origins/destinations should not be a differentiating factor (ie. clause 2.7.2(iv)(A) and (B) should not apply). This is because the process of considering QR's commercial interests should take place during the setting of reference tariffs. It is not appropriate to discriminate against a particular mine on the basis that the tariff proposed by QR and approved by the QCA is considered less attractive by QR than the approved tariff for another origin/destination. Instead, competing applications should be assessed based on the extent to which each applicant is ready and able to use the paths sought (ie. has the necessary production capacity, approvals and network exit capability). In the event that two Access Seekers are equally "ready and able", would both pay tariffs based on reference tariffs, and are not materially differentiated based on contract term or credit risk, then we would expect that the first of these parties to apply for access should be the first to be allocated capacity.
- **Investment Framework:** QR proposes an Investment Framework in which QR will have no obligation to invest in the network and will face no limitations on the terms sought from expanding customers in return for QR offering to finance expansions. New Hope is prepared to accept a relatively 'light handed' regulatory arrangement for QR for the period of the first undertaking, and will seek more prescriptive arrangements in the event that this

flexibility is used inappropriately. However, we do consider that there is a need, in UT1, for greater clarity regarding QR's obligation of offer a 'user funding' option and for this option to represent a credible alternative to QR funding. In particular,

- It is not appropriate that QR should have a right, "in its absolute discretion", to refuse to construct an Extension in the circumstances set out in 1.4.1(a)(iv). The clause should be amended to provide that QR must state the reasons for its objection and set out the changes to the proposed project which would be required to address the stated concerns. Dispute resolution should apply to ensure that the objections raised have a reasonable basis. In addition, the test in part F (that the project does not adversely affect QR's legitimate business interests) should be clarified to ensure that the loss by QR of the opportunity to seek Access Conditions cannot be deemed to adversely affect QR's legitimate business interests. That is, the test of an adverse effect should be that QR is no worse off than had the project not been undertaken, rather than no worse off than had the Access Conditions been accepted.
- We do not consider that it is necessary, in all cases, that Access Agreements be in place for all of the Additional Capacity (1.4.1(a)(v)). For example, if a user funds a project which creates a level of uncontracted capacity, but QR is not worse off as a result of this situation (eg. because the volume forecasts upon which reference tariffs are based exclude the space capacity or because rebates to the user-funder are limited to the contracted tonnes), then the requirement in this section is not an appropriate basis on which QR should refuse to undertake the project.
- The undertaking should provide that the QCA may, during the term of UT1, require QR to submit a more detailed set of arrangements for user funding for approval (and that the QCA may develop these if not provided by QR or if the proposed arrangements are not approved). The undertaking should set out the high level principles for these arrangements, including that they should be tax effective for user funders and should impose no material costs on QR and should not require QR to provide funding. We do not propose that QR should commit to develop more detailed user funding arrangements at this time, as (i) there is not a clear need for this mechanism at present and (ii) if required, we would hope that QR would first seek to voluntarily develop such a framework.
- **Renewal Rights:** Clause 2.7.2(b) to (d) appears to seek to create a renewal right in respect of Train Services for which there is an applicable Reference Tariff. A renewal right for Train Services involving coal haulage is important due to the long term nature of mining investments. We consider that this clause should be amended:
 - to include a process under which QR notifies the Access Holder of the need (and right) to renew a reasonable period ahead of the expiry of this right. This is, it should not be necessary that a competing application exist in order to trigger a notification to the Access Holder.
 - To provide a renewal right for carry-carrying train services operating under a negotiated access charge, such as Colton (ie. the current drafting would not provide a renewal right because there is no applicable Reference Tariff).

- **Recognition of 'Customers':** In respect of coal carrying train services, Access Rights are generally held by train operators for use by specific customers (mines). The undertaking should recognise the interests of these customers, and the undertaking and Standard Access Agreement should provide specific rights for customers. This should include:
 - A requirement that each Access Agreement entered into for coal carrying train services note the identity of the customer.
 - That the renewal right applies to the nominee of the customer rather than to the current Access Holder (ie. the Customer should elect whether to exercise the renewal right itself, through the current Access Holder, or through an alternative operator).
 - That transfers of Access Rights to a different origin/destination cannot proceed without the consent of the customer.
 - That the customer may itself, without the consent of the Access Holder, trigger a transfer of Access Rights to an alternative Access Holder (for example, if the customer is changing above-rail operators or wishes to hold the Access Rights itself).
 - That the customer will have a right (ahead of any other Access Seeker), to enter into a new Access Agreement (including through a new operator) in circumstances where an Access Agreement is terminated by QR due to default by the operator or is terminated by the operator due to default by QR.
- **New Standard Access Agreements:** Clause 2.8 allows the QCA to give QR a notice requiring QR to submit a proposed standard access agreement for a specified type of Train Service not covered by a Standard Access Agreement. New Hope considers that the clause should be widened to allow the QCA to require QR to submit a proposed form of access agreement in which the rights and obligations of above-rail operators are separated from those relating to capacity and payment obligations (end-user access agreement). While New Hope does not see an immediate need for this form of agreement, and understands that there are potential efficiencies in deferring this issue until an end-user agreement is approved for Central Queensland, we consider that the QCA should reserve the right to request this during the term of UT1 if required.
- **Reduction of Access Rights:** The proposed trigger for the reduction in access rights (clause 19 of the standard access agreement) is not appropriate. The test of a failure to use 7 in 12 paths is too short a period in which to trigger consequences which are extremely serious for customers. In addition, the drafting does not provide any process for the access holder to retain the paths by demonstrating that the failure will not be sustained or that there is a long term need for the paths, nor is there any right for customers to be informed of the issue, to remedy the situation or to take over the paths (eg. through an alternative operator) in the case where the failure was the fault of the operator. Permanent loss of train paths could have serious consequences for the customer, and should only apply in extreme cases of sustained underutilisation, particularly given that the proposed take or pay arrangements provide strong protection to QR against any resulting reduction in revenue.

- **Access Charges Escalation:** Schedule 3 of the proposed standard access agreement should clarify that CPI escalation should not apply to Access Charges in circumstances where Access Charges are derived from reference tariffs which are themselves escalated, or which the QCA has determined should not be escalated (eg. because they have been determined taking inflation into account).

Yours faithfully,
NEW HOPE GROUP



Gavan Clarke
Manager Coal Logistics