

26 August 2016

Mr Charles Millstead
Chief Executive Officer
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane QLD 4000

Dear Mr Millstead

Thank-you for the opportunity to comment on the paper prepared for the QCA by Dr Martin Lally, dated 13 July 2016 (*Review of the Australian Competition Authority's Gamma Decision*).

The Queensland Resources Council (**QRC**) provides this submission on behalf of its coal members. The QRC supports the views of Dr Lally, which we understand to be as follows:

- The most appropriate estimate of theta is 1.
- If foreign investors are recognised, which Dr Lally considers is not entirely consistent with the Officer model, then the most appropriate estimate of theta is at least 60%.
- A distribution rate of 0.83 (based on 20 high value listed firms) would underestimate the distribution rate.

Based on this expert analysis:

- A gamma of 0.83, based on the most appropriate theta (of 1), and on a distribution rate of 0.83 which underestimates the distribution rate, would underestimate gamma.
- A gamma of 0.50, based on a theta of 60% which is not consistent with the Officer model and on an underestimated distribution rate of 0.83, would also underestimate gamma.

The QCA's Market Parameters Paper, and subsequent regulatory decisions including in respect of Aurizon Network, adopt a gamma of 0.47. The analysis of Dr Lally suggests that this estimate is too low.

QRC has accepted the QCA's final decision on UT4 in respect of the WACC, including the gamma, and does not wish to re-prosecute the arguments on each element of WACC under UT5. However, we maintain our view that an estimate of 0.50 would be at the lower extreme of a reasonable range. This is supported by the analysis of Dr Lally. We also support the statement of the QCA (QCA Final Decision, Aurizon Network 2014 Access Undertaking, April 2016, page 283) that *"there is nothing in the [Australian Competition] Tribunal's reasoning that demonstrates that our approach to estimating gamma is inappropriate"*.

We remain concerned that that the QCA's estimate of gamma errs on the low side, as demonstrated by Dr Lally, and that this results in an over-estimation of Aurizon Network's efficient costs. The QCA considered the consequences of under and over-estimation of efficient costs in its Draft Decision on Aurizon Network's 2014 Access Undertaking, Maximum Allowable Revenue, September 2014. The QCA stated on page 188 that *"We also agree with the QRC*

that, while the investor's perspective is important, it is not the only relevant consideration. Efficient investment does not include under-investment or over-investment. As the QRC suggested, while under-investment in the rail infrastructure has negative implications for Aurizon Network and its investors (and the coal industry through potential lack of future capacity), over-investment also has negative implications as it may lead to under-investment at other functional levels of the coal supply chain, including mine development".

We maintain the view that:

- the WACC estimate, and the estimates of efficient costs including tax costs, should be the best estimate available, and therefore should not err on the high side.
- based on the analysis of Dr Lally, the gamma estimate adopted by the QCA (0.47) errs low the low side, resulting in an over-estimation of Aurizon's efficient costs..

The QRC confirms this submission may be made public. Thank you for your consideration of our submission. Please contact Andrew Barger Director, Infrastructure and Economics on 3316 2502 or andrewb@qrc.org.au for further information on this matter.

Yours sincerely



Michael Roche
Chief Executive