

November 2011

Mr John Hall
Chief Executive
Queensland Competition Authority
BRISBANE QLD 4001

Dear Mr Hall,

The Queensland Resources Council (QRC) appreciates the opportunity to provide this response to assist the Authority's assessment of QR Network's 2010-11 revenue-cap variation application.

The Authority's approval of QR Network's 2010 Access Undertaking resulted in a number of refinements to the hybrid revenue-cap regulatory regime which was implemented during 2006 to remove QR Network's exposure to volume risk. These recent changes have further reduced QR Network's risk profile by allowing end of year adjustments to System Allowable Revenues for a number of factors which may influence QR Network's operating and maintenance costs.

Given the significant impact of weather events on actual railings during 2010-11, represented by a 21% shortfall compared to forecast volumes across the central Queensland coal network, the Authority's assessment of QR Network's revenue-cap application will be particularly important. The Council notes that this 21% volume shortfall resulted in a revenue deficit of around 7.7%, which highlights the significant role which take or pay is now playing in securing QR Network's regulated revenues. The fact that this 7.7% revenue deficit is fully recoverable by QR Network in 2012-13, meaning that QR Network ultimately suffers no loss from the extraordinary weather events of last summer, highlights the extent to which QR Network is insulated from the risks faced by its customers.

QR Network's application refers to two specific matters which require further review.

- The apparent inequitable results from different capping arrangements applying to Take or Pay (as between UT2 and UT3 Access Agreements), arising from differing definitions of Total Actual Revenue. This appears to be an unintended outcome of drafting contained within QR Network's 2010 Access Undertaking. While QR Network has sought to propose an equitable solution for 2010-11, this is likely to be inconsistent with the rights of specific Access Holders under their Access Agreements.
- Consideration of Take-or-Pay relief for railings from hauls with similarly located origins and/or destinations. The Council notes in this case, QR Network has not proposed to depart from the strict application of Access Agreements.

Regardless of the merits of proposed solutions to perceived inequitable outcomes for the previous financial year, the Council considers that departing from contractual rights (as proposed by QR Network in regard to the first issue) would require agreement from affected Access Holders.

Going forward, the Council considers that amendments to the Undertaking should be considered in order to prevent similar issues from arising in the future. The Council notes that this must be achieved without forcing amendment to existing contracts, other than amendments which automatically flow to certain contracts via 'uplift'/review event provisions within these contracts.

In terms of the details of QR Network's application, given the current contractual arrangements between end-customers, above-rail operators (QR National and Pacific National) and QR Network, only the Authority and QR Network have access to the information required to prepare and assess this application. This includes the contracted paths within QR Network's access agreements (by individual train service), various commercial agreements (such as the access facilitation deeds), and QR Network's financial models used to determine revenue adjustments.

In the absence of the above information, the Council is constrained in its ability to draw any conclusions or make absolute recommendations. As such, the process of independent verification by the QCA (which must include verification and consultation with individual coal companies) is critical to ensuring a thorough assessment by the Authority of QR Network's application.

The Council remains concerned that this revenue-cap adjustment application highlights, and to some degree reinforces, the concern that pricing incentives exist for coal producers to contract for diesel rather than electric train services on the Blackwater System. The very significant increases in electric access charges for Blackwater System users, the apparent operational limitations of the electric network, as well as fleet composition and allocation practices are not new issues.

The Council and individual companies have raised this matter on a number of occasions, although at this time there remains no clear pathway to address this issue.

Moreover, the large under-recovery for Blackwater electric assets (which will impact on future Blackwater electric tariffs) will only further accentuate the 'unattractiveness' of electric above-rail investment in this system. The Council is concerned that the underlying problem remains and the longer the period of inaction, then the greater the risk that the 'stranding' of the Blackwater electric assets will move from a theoretical concern to (in the absence of some form of intervention – such as pricing or operational arrangements) a practical reality.

To the extent that coal producers use the Blackwater electric reference tariffs as a means of informing investment decisions (including haulage contractual decisions and new mine rail infrastructure requirements), it is reasonable to expect the situation will only worsen before the next regulatory reset. If not addressed within the short-term, this positive feedback loop will only further worsen the problem to the point where there is a real possibility of an asset stranding problem, to which optimisation of the electric assets could be the only effective solution.

Industry relies heavily on the QCA undertaking a thorough assessment of this application, and requests that QCA maximises transparency, subject to substantiated confidentiality constraints, in order to assist end-customers to confirm and understand the nature of the proposed revenue adjustment. To assist, QRC has attached a range of matters that may require consideration by the QCA in order to assist the consideration of the proposed revenue-cap variation.

Should you wish to discuss any of the issues raised in this submission, the Council would welcome the opportunity to assist with the Authority's considerations of these matters.

Yours sincerely

Russell Silver-Thomas
Industry Policy Advisor

Proposed matters to be considered within QCA's assessment of QR Network's application

QRC considers that the QCA's assessment and subsequent published decision regarding the proposed revenue-cap variation must comprehensively address the following:

- QCA to verify the Maintenance Cost Index, Consumer Price Index and necessary X-factor adjustments have been applied appropriately, including:
 - Publishing for each individual coal system the approved maintenance allowance that corresponds to the proposed increase to maintenance and operating costs.
 - Outlining the reasons for certain operating costs (specifically, those relating to the risk premium allowance) not being subject to the X-factor. QRC notes the QCA's 2010 Pricing Decision stated that the building block cost estimates of operating costs were subject to the X-factor being applied.
- Transparent verification of QR Network's financial models to ensure these are correctly calibrated to determine the revenue-cap variation amounts.
 - Reconciling actual tonnages railed by origin-destination (and therefore revenue received by origin and destination) with available volume data.
 - QR Network and the QCA should provide all customers (coal companies) the data underpinning actual and regulatory forecast railings (i.e. train paths and tonnages by origin/destination).
- Reviewing financial model parameters and assumptions to ensure they are consistent with the provisions of QR Network's approved Standard Access Agreements, executed Access Agreements and relevant regulatory decisions. The following key calculations will need to be accurately determined:
 - Take-or-pay revenues based on:
 - Actual railings and contractual commitments in Access Agreements; and
 - Formulae contained in the relevant 2001, 2006 and 2010 Access Undertaking Standard Access Agreements.
 - Relinquishment and Transfer fees based on:
 - Confirmation of transfers or relinquishments undertaken within the period, verified by reviewing any amendment to Access Rights contained in Access Agreements; and
 - The calculation of the relinquishment or transfer fees (if any) using the relevant formula.
 - QR Network's financial models need to be thoroughly tested and independently audited in order for industry to be confident in the revenue variation assessment.
- Reviewing QR Network's proposed rebate model and estimates relating to agreements described in clause 6.5.2(d)(i) – commonly referred to as 'access facilitation deeds'.
 - Reconciling the rebate calculations with the commercial agreements.
 - Verification of estimates against QR Network's Access Conditions Register.
 - As necessary, verification from end-customers as to the arrangements.

- QCA provide information from each QR Network financial model which relates to each individual train service to the respective end-customer (relevant mine operator), in order for this information to be independently verified. This would include:
 - Identification of the applicable internal access agreement (and/or other relevant contractual documents) which relates to these end-customer train services by origin-destination and train paths – including expiry date and details of the relevant terms and conditions (such as whether the path was grandfathered).
 - The below-rail ‘take or pay’ revenue deemed recovered under the internal access, or related agreement.
 - The actual number of ‘QR Network Cause’ events directly relating to each individual train service (by origin-destination) and the number allocated by the proposed pro-rata methodology (including the financial impact of this allocation on ‘take or pay’ liabilities).