



27 July 2009

Mr John Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Mr Hall,

QR Network's Draft Amending Undertaking West Blackwater Reference Tariff

We welcome the opportunity to comment on QR Network's (QRN) Draft Amending Undertaking West Backwater Reference Tariff and appreciate the additional time afforded us in preparing our response.

The current tariff proposal by QRN is highly unusual given QRN had previously proposed and the QCA had accepted in its draft decision a reference tariff of \$5.67 per net tonne. Subsequently QR withdrew the proposed reference tariff and proposed a revised reference tariff of \$4.60 a net tonne, with the rate to be backdated to July 2007.

Although not clearly articulated in the documentation submitted to the QCA, QRN has informed Asciano it will not be increasing non coal charges or other coal haul charges to recover the reduced revenue under the new tariff. Based on information provided to Asciano by Felix for the relevant mine (Minerva), a \$5.67 charge per tonne with the associated retrospective backcharge was a significant commercial impost, and had been raised in commercial discussions regarding above rail haulage with QR National. Based on our understanding of the economics of coal exports in Queensland, an impost of an additional \$1 per tonne in rail access charges will not affect the viability of the mine. The decision by QRN is clearly not a profit maximising decision for QRN. Thus we conclude that there is no commercial justification for QRN's decision unless it is taking into account non QRN factors.

Over the past number of months, Asciano and QRNational have both been involved in commercial negotiations with Felix to secure its above rail haulage contracts in both NSW and Queensland. Towards the conclusion of this process, Felix informed Asciano that a key decision factor for the awarding of the above rail contracts was a change in QR's position for Minerva, comprising both above and below rail changes.

Based on this evidence and the subsequent awarding of the above rail contracts to QR National, it appears that QRN may not have been operating as a stand alone business but has taken a non commercial position in order to facilitate the winning of an above rail contract for its related company. If this is the case, QRN has provided a cross subsidy from the monopoly network business to the competitive business, the latter a business that is soon to be placed up for sale.

In the market in Queensland where true above rail competition is just developing, it is vital that the monopoly track provider which is part of a vertically integrated organisation, operates independently making commercial decisions purely in its own interests and does not distort competition in the above rail markets. Accepting an undertaking which allows competition to be distorted in this way is not in the public interest and is not consistent with the objectives of Part 5 of the QCA Act to promote the economically efficient operation of, use of and investment in relevant infrastructure.

Asciano has two major concerns:

1. the non standard way in which the tariff has been calculated, and
2. the potential impotence of the current ring fencing arrangements in the undertaking highlighted by this situation. We believe the ring fencing arrangements must be strengthened in UT3.

Revised Calculation of tariff

The calculation of the revised tariff, when compared to the QRN's original methodology and accepted Australian regulatory practice, is at best unusual. QRN has allocated almost half the RAB to non coal traffic. The allocation of an asset base between traffic is a very unusual approach. The method of allocation using a pure path based allocation is also irregular. This extreme allocation method will not accurately reflect the traffics' relative costs. This approach is a significant change from the pure gtk approach, which was also questioned by Asciano, in the previous submission.

Failure of Current and Proposed Undertaking Ring Fencing Arrangements

The current and proposed ring fencing obligations focus on three key areas:

1. organisational structure
2. accounting separation, and
3. confidential information.

We discuss the limits of the first two areas below. Asciano's key concern is that with the exception of pricing, there is no positive obligation on QRN not to discriminate between above rail operators and no positive obligation to act only in the interest of QRN. As a result the current and proposed ring fencing arrangements in the Undertaking don't prevent the possibility of QR distorting above rail competition.

QR has heralded the setting up of QRN as a separate company as a step forward in its separation and independence. However, the underlying board structure and QR constitution by definition undermine the effectiveness of this separation.

QR has established a subsidiary, QRN, which is separate from QR operational business groups. QRN has the primary function of managing the provision of below rail services. UT2 sets out the responsibilities of QRN and of the QR operational business groups and requires QR to obtain QCA approval for any variation to this operational structure (cl3.1).

The members of the Board of each subsidiary comprise QR's CEO, CFO and the relevant Executive General Manager.¹ This means that the CEO and CFO will be common directors between QRN and QR operational business groups. They will share information at the Board level and will also have access to information under UT2 (cl3.3.2(a)). This puts the CEO and CFO in a potential position of conflict.

Typically directors of companies are required by the Corporations Act to act in good faith in the best interests of that company.² However, as the QR subsidiaries are wholly owned subsidiaries of QR, the directors of the subsidiaries are allowed to make decisions which are in the interests of the holding company, i.e. QR, if the Constitution of the subsidiary expressly allows the directors to take these interests into account and the directors act in the best interests of the holding company.³ The Constitutions of all QR subsidiaries allow the directors of those subsidiaries to act in the best

¹ QR's Preliminary Submission to the QCA on the 2008 Access Undertaking, May 2008 (paragraph 2.3).

² section 181 of the Corporations Act 2001 (Cth).

³ section 187 of the Corporations Act 2001 (Cth).

interests of QR.⁴ This means that the directors of QRN can act in the best interests of QR which would necessarily take into account the interests of the QR operational business groups.

The undertaking requires QRNA to keep separate accounts and have them audited (cl3.2). However, there is no provision which prohibits the effective cross subsidy described in this instance or even above the line cross-subsidies being paid by QRN to QR operational business groups. Presumably such a cross-subsidy would be disclosed in the accounts but there is nothing to prohibit this in the UT2. Therefore the provision of such a cross-subsidy would not breach the undertaking unless it involved a breach of the confidentiality provisions or accounting separation provisions. Neither the QCA nor any other person could take action for breach of the undertaking under section 158A of the QCA Act.

The current issues regarding Minerva below rail pricing and above rail competition has highlighted the limited protection the proposed UT3 ring fencing arrangement provide above rail operators competing with QR's monopoly track provider and its vertically integrated above rail business.

We would welcome the opportunity to have a further discussion with the QCA on how these ring fencing obligations could be strengthened with the focus on QRN having positive obligations to act in their own interests and not discriminate between above rail operators.

Kind Regards

A handwritten signature in blue ink that reads "Tim Kuypers".

Dr Tim Kuypers
GGM Access & Regulation

Cc Paul Bilyk, QCA
Cc Mike Carter, QR Network
Cc Russell Silver Thomas, QRC

⁴ QR, Board Directive: Corporate Governance – QR Subsidiaries, paragraph 4 (www.qr.com.au).