

Submission to QCA

Proposed Investment Framework

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Dear My Bilyk

Submission on Issues Paper for Proposed Investment Framework for QR Network

This submission is made by Macarthur Coal Limited, Jellinbah Group Pty Ltd and QCoal Pty Ltd (**Submitters**) in response to the Queensland Competition Authority's (**QCA**) Issues Paper entitled 'Proposed Investment Framework' (**Issues Paper**) for QR Network Pty Ltd (**QR Network**) that was released for comment on 22 July 2010.

The Submitters generally support the submission lodged by the Queensland Resources Council (**QRC**) on 30 July 2010. However, there are two matters of particular concern with the Issues Paper that the Submitters would like to see addressed by the QCA.

Incentives for QR Network to invest in expansions

The Submitters welcome the principle outlined in paragraphs 12 and 13 of the Issues Paper that QR Network should fund expansions of the network valued at more than \$300 million unless either users propose to fund all or part of the expansion or QR Network is constrained from doing so due to its inability to raise finance or due to its own capital management issues.

The problem lies in the means proposed in the Issues Paper for setting the terms on which QR Network will invest as it is clear that the QCA is not proposing that QR Network will be required to finance an expansion nor is it proposing to set the return that QR Network can derive from any decision to fund an expansion. The machinery for determining the terms on which QR Network will fund an expansion are largely left for QR Network to determine, with the option of having the QCA arbitrate in the event that the parties are unable to agree on those terms. However, the QCA will not set the conditions but merely rule on whether the QR Network terms are appropriate. If QR Network still chooses not to invest on the conditions determined by the QCA, it can simply refuse to provide any funding.

For industry participants who may not have ready access to capital to fund expansions of the network, they will be reliant on QR Network to fund expansions. For these companies, the ability to self fund does not impose any practical constraint on QR Network's funding terms (as the QRC has suggested in its submission), because the user funding option is illusory.

The absence of a firm obligation to fund an expansion or a process for setting the terms on which QR Network will fund an expansion means that those industry participants will be beholden to QR Network's proposed funding conditions. Rejection of those conditions will mean that QR Network could simply refuse to invest.

While the 'shaming' process of referring a dispute with QR Network to the QCA and have the QCA determine that the conditions proposed by QR Network are not reasonable will assist to apply some pressure to QR Network, it will still be left entirely to QR as to whether it will accept those terms. If QR

Network does not, the industry participants who can not access capital to user fund an expansion will be left without a path forward. The Submitters' view is that this process does not adequately address the imbalance between the monopolist and its customers.

The Submitters acknowledge that, in certain circumstances, it may be appropriate for QR Network to earn a return on capital for an expansion in excess of the regulated WACC to reflect the increased risks of that investment. If that return is reasonable taking into account all of the circumstances surrounding the expansion then the Submitters would be prepared to accept what has been offered and move forward. The concern, however, is that where the proposed return (and other conditions) are not reasonable taking those matters into account, then the Issues Paper does not propose any mechanism to readily resolve the dispute and leaves the final commercial outcome entirely within QR Network's control.

While the *Queensland Competition Authority Act* imposes some constraints on what can be determined under an access determination, the same constraints do not necessarily apply to the terms of an access undertaking. The Submitters would like to see a process included in the access undertaking that requires QR Network to invest (except in the case of genuine inability to obtain funds) on conditions determined by the QCA.

Rights given to user funders

The Submitters' would also like, greater clarity on the rights that are intended to be conferred where a user funds an expansion.

The relevant principles in the Issues Paper are set out in paragraphs 15 to 20. The Submitters understand that the QCA's proposal is as follows:

- (a) a user who funds an expansion will be compensated for its investment through a rebate on its access charges from QR Network;
- (b) if a user funds an expansion it will have a priority entitlement over other companies who are seeking access but who have not agreed to fund the expansion;
- (c) the user who funds an expansion can fund all or part of the expansion. If a user funds all of an expansion but part of that expansion is to meet the needs of other users then the other users will be entitled to their nominated share of the expansion, subject to those users agreeing to the funding conditions; and
- (d) conversely a user who agrees to fund more of an expansion than its nominated requirements is not entitled to priority to the capacity generated in excess of its nominated requirements unless other users fail to take up their nominations.

The key issue for the Submitters arising out of these principles is whether or not a user who funds an expansion can retain all of the capacity even if it is not required by that user. If this is contemplated, then the Submitters request the rationale for it be reconsidered, as it could lead to market foreclosure issues and inefficient or under utilisation of the available capacity.

Another aspect of these principles that needs clarification is the 'premium' that the QCA contemplates may be charged by the user funders if they finance capacity for other users. It is acknowledged that the access undertaking may not be able to address this issue. However, the manner in which it is raised in the Issues Paper suggests that the right to earn an above regulated return can be transferred from QR Network to a competitor of the person seeking access in circumstances where there are no controls over the level of the return that can be demanded and the funder has a clear incentive to demand an inflated return.

The Submitters believe that greater thought needs to be given to the issues created where a user funds an expansion and the capacity generated exceeds the level that the funder requires.

Summary

The Submitters thank the QCA for this opportunity to comment on the Issues Paper. While the Submitters are generally supportive of the QCA's approach and the QRC's response, the two additional issues that the Submitters would like to see addressed are:

- (a) a binding process for determining the rate of return and other access conditions that QR Network is entitled to receive from an expansion; and
- (b) clarification that a self funded user who funds all of an expansion does not get priority to all of the capacity created but the priority is limited to the capacity that the user had nominated it required.