



30 July 2010

Mr Paul Bilyk  
Director  
Queensland Competition Authority  
Level 19 , 12 Creek Street  
Brisbane QLD 4001

Dear Paul

### **QCA Proposed Investment Framework**

Thank you for the opportunity to respond to the QCA's proposed Investment Framework which aims to guide the development of an appropriate investment framework in QR Network's 2010 Access Undertaking (AUT3). Considered in the context of the proposed privatisation of QR National as a vertically integrated above and below rail coal business, the AUT3 Investment Framework is of critical importance to the bankability of our existing and future mining projects which are heavily reliant on continued investment in below rail infrastructure.

As previously advised, there are four major areas of concern which are essential to the development of a robust and defensible AUT3 Investment Framework:

1. **Excessive returns.** AUT3 must not allow QR Network to make investments at returns exceeding the regulated rate, except where there is a clearly defined process for the QCA to impose access conditions to manage additional risks in future infrastructure expansions.
2. **Abuse of Monopoly Power.** AUT3 must provide a clear and defined mechanism whereby users have the right to fund expansions at their option.
3. **Expansion delays.** AUT3 must provide feasible coal expansion pathways to ensure a coordinated approach to investment planning across the coal chain, and to encourage timely expansion.
4. **Foreclosure of competition:** AUT3 must not abuse its monopoly power in the below rail market to extract monopoly or market power in the competitive elements of its business (eg in the market for rail haulage services and the market for finance).

We believe the Proposed Investment Framework addresses these four concerns and represents the first meaningful step forward for industry in securing the necessary regulatory protections to prevent QR Network from abusing its monopoly position via threats of investment hold up. We fully support the implementation of these regulatory protections in the QCA's Final Decision and would like a transparent and competitive investment framework given immediate effect. We also strongly endorse QRC's submission in relation to the Investment Framework.



At the same time, we recognise that there are limitations which remain in the current regulatory process. Specifically, the Investment Framework clearly states that the QCA's position is that "*QR Network cannot be forced to fund an expansion*"; that "*an expansion may include a number of projects on different parts of the network*"; and "*in the event the [QCA] forms the view QR is able to raise finance, the decision on whether to invest will rest with QR*". Given these views, it is clear that QR Network's mandatory investment obligations cannot be relied upon to deliver future expansions, especially given that QR Network may aggregate projects in order to take them above the \$300m limit for mandatory expansion.

However, this position may be acceptable provided that the QCA's 'Foundation Premise' that "*users should have the right to fund expansions at their option, even if QR Network is willing to do so*" is properly implemented in the Access Undertaking to ensure that this right is one that is available to users in a way which can be practically exercised by them. The user funding model is potentially the most effective counterbalancing of QR Network's monopoly power and may neutralise QR Network's ability to exercise any monopoly power through a regulatory framework which was designed to protect industry from such behaviour. This potential is not realised in the current draft AUT3, since QR Network's user funding model does not yet provide a credible and competitively robust industry investment alternative. Of most concern is the fact that a lack of clarity around processes underpinning the user funded model could provide a significant opportunity for QR Network to frustrate and stifle any attempt by industry to self fund its own expansion pathways.

We do believe that if the user funding principle is properly implemented to provide a right which can be practically exercised by industry, then it will be a considerable protection against QR Network monopoly power and provide an incentive for expansion of the network. We have previously provided base documents which embody some of the key principles which would be necessary for an acceptable user funded model, and we attach a short paper setting out the key principles as we see them.

We understand and support the 'small' and 'large' miner protections you have embedded in the Investment Framework, however, we reinforce the fact that the QCA's 'no forced' expansions principle must be similarly reflected in the user funding model. At present there is some ambiguity as to whether self-funding users have the ability to scale the scope of an expansion such that it will deliver the most efficient increment of capacity aligned to the relevant user funding approvals. Our position is that users cannot be forced to fund expansions on behalf of mines who chose not to participate in a user funding agreement. Any scaling up of capacity to include the needs of non-funding users can only be with the agreement of funding users.

Accordingly, a useful addition to the user funding model is the inclusion of third party equity as an additional funding source available for users who may not want to fund the expansion from their balance sheet. This would allow all users to fully investigate their investment options and competitively source project finance from third party investors. Such investors could include others miners, bank/financiers or other coal related infrastructure providers like an export coal port). Funding arrangements could then be competitively negotiated so the most efficient form of capital can be accessed by all users. In our previously provided base documents, we outlined the funding mechanisms required to ensure (a) small mines cannot be locked out of the expansion process due to insufficient funding capability; and (b) that the premium paid by non-funding mines fully reflects the additional costs attributable to locating competitive finance to underpin the project's scale and scope.

We fully endorse the Investment Framework's principle that "*the investment decision process...should be independent of who funds the investment*". One of the inherent flaws in the current regulatory regime is the unwillingness for QR to progress pre-feasibility or feasibility studies in a timely manner to align with a mine development's project studies. Given the significant investment costs facing mines in expanding the rail network, the impact those costs have on a mine's project could be the critical factor in whether a project goes ahead. As you are aware we have significant reservations on the effectiveness of the AUT2 Coal Rail Infrastructure Master Plan (CRIMP) process to manage and implement industry's expectations for coordinated and timely coal chain investment processes. To give effect to the expansion process in the Investment Framework, regulatory obligations must be imposed on QR to manage and develop comprehensive pre-feasibility projects to anticipate the potential expansion and extension options available to meet industry's growing demand needs and so industry can access capacity with reasonable notice to QR.



A useful addition to the expansion process is a mechanism for industry to resolve the pricing arrangements to apply to an expansion prior to mines being required to make an investment decision. Such a process could be conducted within the QCA's approval process regarding any access conditions or risk adjustments required to underpin an investment decision or as a separate process which can be initiated either by QR Network or users.

In terms of next steps, we recommend QR Network be directed to include the Investment Framework (inclusive of high level principles on user funding obligations held by QR) with immediate effect in the next draft of AUT3. We understand the AUT3 will outline a subsequent implementation process to enable tripartite discussions on the specifics of implementing the new Investment Framework and that the QCA will have final arbitration rights on the scope and process ultimately embedded in AUT3. We believe the QCA's final arbitration rights will be essential to ensure QR Network is held accountable in the implementation of the Framework.

At the same time, we recommend the QCA includes transitional investment arrangements in AUT3 to enable industry to apply a user funded model to negotiations with QR Network on current network expansions. As you are aware, QR Network is currently seeking to commercially negotiate with WICET Stage 1 users outside the AUT2 regulatory framework. Given the Investment Framework will effectively remove the level of monopoly power QR Network is seeking to exercise in these negotiations, it is essential that these principles be embedded in AUT3 with immediate effect.

We look forward to participating further in the development and implementation of the QCA's Investment Framework.

Please do not hesitate to contact my office in relation to this letter.

Yours sincerely

Reinhold Schmidt  
Chief Operating Officer  
Xstrata Coal Queensland Pty Ltd

### User Funding Agreements - Key Principles

The key principles for a user funded expansion should ensure that in return for funding an expansion, a user will receive a priority right to access on time and to budget, and should obtain a return on its capital employed which reflects cost of capital and risks involved in the project.

	<b>Issue</b>	<b>Summary</b>
	<b>Application</b>	Users have the right to fund all rail infrastructure expansions and extensions at their option.
	<b>Capital drawdown</b>	Users will provide funding to QR Network based on an agreed cost estimate for the project, subject to substantiation of the actual costs incurred in relation to the project.
	<b>Project management</b>	The user will have approval rights at set "gateways", e.g. concept, pre-feasibility, feasibility, design and construction.
	<b>Approvals</b>	The user's approval will be required for major items including; <ul style="list-style-type: none"> <li>• project design and budget; and</li> <li>• all contracts for the delivery of the project</li> </ul>
	<b>QR Network responsibility</b>	QR Network is responsible for project delivery in accordance with the approved design and specifications, and to the agreed budget and timetable.
	<b>QR Network obligations</b>	QR Network has an obligation (and defined process to manage the implementation of the obligation) to: <ul style="list-style-type: none"> <li>• co-ordinate, assist and facilitate user funded expansion projects on or adjacent to its rail infrastructure, including access rights to the existing rail corridor</li> <li>• ensure access to corridor land will be provided wherever reasonably possible, with safety being the only criteria to justify refusal to provide access;</li> <li>• facilitate and enable the utilisation of QR Network's corridor land in order to address scarcity of land and any government land use planning requirements when approaching large population zones;</li> <li>• provide full access to all studies, engineering expertise, construction processes and relevant QR Network expertise where there have been QR Network caused delays in the construction of an expansion.</li> </ul>
	<b>Reporting and access</b>	QR Network is obliged to make regular reports on progress to the user funder, and the user funder is allowed access to the site and relevant records to inspect progress.



<b>Maximum funded amount</b>	There will be a maximum amount which the user is required to fund which is linked to the agreed budget. The funding user is not required to fund any amount in excess of the maximum amount unless it falls within one of the agreed cost pass through categories.
<b>Right to access</b>	The user funder has the first right of refusal to the capacity created by the project that it funds.
<b>Return on capital</b>	<ul style="list-style-type: none"> <li>• Funding provided by the user will not be included in the regulated asset base for the purpose of calculating the user's access charges.</li> <li>• Non-funding and subsequent users will pay an access charge which includes a premium to compensate the user funders or third party equity providers for financing the expansion.</li> <li>• For the purpose of calculating the premium, it reflects the costs incurred for the period prior to commissioning, and in respect to any latent capacity until it is utilised.</li> </ul>
<b>Completion</b>	Completion of the planned expansion should occur through a planned commissioning process, including independent certification that the project has been completed and is performing as planned.
<b>Security for availability of user funds</b>	User to demonstrate that it is creditworthy before the commencement of the project in order to ensure the availability of drawdowns, or security for drawdown amounts to be provided.
<b>Termination</b>	User may terminate the arrangements on the occurrence of default by QR Network, including defined events of default relating to QR Network solvency. QR Network must repay the funds advanced prior to the default.