QUEENSLAND resources COUNCIL

Working together for a shared future

27 January 2010

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 2009-10 revenue-cap variation application.

QR Network's 2010 Access Undertaking resulted in a number of refinements to the hybrid revenue-cap regulatory regime. This regime was originally sought by QR Network during 2006 to remove its exposure to volume risk, by means of the revenue-cap adjustment. Recent refinements enable QR Network to adjust components of its maintenance costs, forecast and actual escalations and other approved cost pass-through elements for electric energy and connection costs.

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

In the absence of the above information, QRC 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 thorough assessment by the QCA of QR Network's application.

The provision of commentary explaining the principal drivers of material variations is important, as end-customers will be liable for future increases/decreases in access charges to recover/return any approved revenue variation. Previous revenue-cap assessments have focused heavily on the process to calculate the necessary revenue adjustment, although have not provided any explanation outlining the underlying reasons for the revenue-cap variation. Understanding the key drivers of variations is

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important to industry, as this understanding may indicate a need to take certain actions, including in regard to pricing signals.
QRC is concerned that the current revenue-cap adjustment application highlights, and to some degree reinforces, a 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. This matter was previously raised within QR Network's September 2008 submission and proposed draft access undertaking, which sought to combine the Blackwater and Goonyella electric assets into a single tariff.

However, following the QCA's draft decision, QR Network withdrew its proposal and no alternative solution has since been considered, nor discussed. QRC 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.

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.

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, QRC would welcome the opportunity to assist with the Authority's considerations of these matters.

Yours sincerely

Russell Silver-Thomas
Industry Policy Advisor

Attachment 1.

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

QRC offers the following issues and proposals as matters which the QCA should consider in order to complete the assessment of the proposed revenue-cap variation applications. These include:

→ QCA engaging an independent consultant to assess QR Network's financial models to ensure these are correctly calibrated to determine the revenue-cap variation amounts.

- 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.
- Reconciling the actual tonnages railed by origin-destination (and therefore revenue received by origin and destination) with available volume data.
- Reviewing financial model parameters and assumptions to ensure they are consistent with the provisions of QR Network's approved access undertaking and relevant regulatory decisions.

→ Reviewing QR Network's access agreements, including the application of below-rail 'take or pay' to grandfathered and 2001 Access Undertaking train service entitlements.

- Reconciling the 'take or pay' liabilities by each individual train service (as per the access agreement) by application of the requirements of the relevant standard access agreement conditions.
- Internal access agreements (including all grandfathered paths) should be audited against QR Network's 'take or pay' model.

→ 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).

→ QCA to verify the Maintenance Cost Index, Consumer Price Index and necessary X-factor adjustments have been applied appropriately.