

Queensland Rail's Response to the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (DAU2)

11 July 2019

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The logo for Queensland Rail, featuring a stylized 'Q' and 'R' icon followed by the text 'QueenslandRail'.

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1. Background

On 29 April 2019 the Queensland Competition Authority (QCA) released its Draft Decision (**Draft Decision**) on 'Queensland Rail's Draft Access Undertaking 2' (**DAU2**). Submissions in response to the Draft Decision are due by 11 July 2019. Queensland Rail appreciates this opportunity to respond to the Draft Decision.

2. Reference Tariff

2.1 Revised Tonnage Forecast

At the time of lodgement of DAU2 Queensland Rail forecast a lower tonnage level of 2.1 million tonnes per annum (**mtpa**), all being produced by Yancoal if New Acland Mine Stage 3 (**NAS3**) does not progress, and 9.1mtpa (7mtpa from New Hope) if NAS3 proceeds. Queensland Rail now has updated forecasts of a lower tonnage scenario of [REDACTED] and a high tonnage scenario of [REDACTED].

Yancoal has recently received approval to expand production from 2.8 mtpa run-of-mine (**ROM**) to 3.5 mtpa ROM. This is expected to increase product tonnes available for railing and shipment to [REDACTED] and the mine is expected to be operating at this level at commencement of DAU2. Based on advice from New Hope, the forecast for NAS3 has [REDACTED] due to operating conditions associated with the approval of NAS3 and infrastructure limitations with train loading and the capacity of the coal preparation plant. At the date of this submission there remains no certainty that NAS3 will proceed. Queensland Rail has amended its capital and maintenance programs to reflect these tonnage levels.

2.2 87 Train Path 'Constraint'

The QCA in both its 2016 Final Decision (**Final Decision**) on 'Queensland Rail's Access Undertaking 1' (**AU1**) and DAU2 Draft Decision incorrectly determined that Queensland Rail was not permitted by the Department of Transport and Main Roads (**TMR**) to contract more than 87 return coal train paths through the Metropolitan System (**87 Train Path Constraint**), even if there was demand for the additional available paths. Queensland Rail in its response to the 2015 QCA Draft Decision confirmed that there is no 87 Train Path Constraint, and included its legal advice on this point.¹ The QCA's view has been largely based upon historical correspondence from TMR that has been superseded.

The effect of applying the 87 Train Path Constraint is to reduce the allocation of maintenance, operational and capital costs to the coal reference tariff, materially lowering the reference tariff. As a consequence, Queensland Rail cannot recover the efficient costs of providing services on the West Moreton System in accordance with the pricing principles of s.168A of the *Queensland Competition Authority Act 1997 (QCA Act)*. In the 2016 Final Decision the QCA required that Queensland Rail provide evidence that TMR had removed the 'constraint' or that there was no constraint.² TMR has confirmed to the QCA in correspondence dated 24 April 2019 (attached) that there has not been an 87 Train Path constraint since (at least) 2015, consistent with Queensland Rail's advice during AU1 approval, writing:

"The insight gained from completed planning reports enabled TMR to determine that full utilisation of the 113 train paths available on the metropolitan Brisbane network, including those not preserved under TIA, did not present a challenge to passenger train operations. This outcome has since been used as a core traffic baseline in any new investigations involving passenger train services.

I am not aware of a specific date or visible marker of a change in TMR's position subsequent to 2015. However, I note in correspondence dated 23 December 2015, TMR formally recognised Queensland Rail's sole responsibility to determine the allocation of available train paths on the corridor while ensuring the continuing existence of 16 non-coal preserved freight train paths.

TMR advice provided to Mr Sam Fisher, General Manager Marketing and Logistics (New Acland Coal Pty Ltd/New Hope Group) in a 12 November 2018 letter reaffirmed this position..."

With the QCA having received clarification from TMR Queensland Rail submits that the QCA must calculate the reference tariff for both the higher and lower tonnage scenarios without applying the 87 Train Path Constraint.³

¹ Queensland Rail's Response to Queensland Competition Authority's Draft Decision to refuse to approve draft access undertaking, December 2015, pp 30, 42, 49, & Annexure 8.

² QCA Decision Queensland Rail's Draft Access Undertaking, June 2016', p. 125

³ Queensland Rail has also demonstrated through its business practices that it does not apply an 87 Train Path Constraint. For example, Queensland Rail's West Moreton Regional Network Master Planning process presentations that were made to the West Moreton Regional Network Master Planning Forums on 5 April 2017 and 10 December 2018 clearly state that the current capacity of the West Moreton System is approximately 9.5 mtpa and that 97 return paths can be contracted for coal services from the West Moreton System through to the Port of Brisbane. Further, tonnage scenarios are based upon there being no 87 Train Path Constraint, and will contract more paths if the relevant infrastructure expansions are progressed (up to 20mtpa).

2.3 WACC

Queensland Rail sought to minimise debate with respect to allowed returns in DAU2 by accepting the Weighted Average Cost of Capital (**WACC**) methodology adopted in the QCA's draft decision on Aurizon Network's 2017 draft undertaking (**UT5**) (which was consistent with the QCA's historical 'bottom up' approach to WACC), save to update the Asset Beta and associated Equity Beta. In doing so Queensland Rail reserved the right to revise its position if the QCA was to change its approach.

In its UT5 Final Decision the QCA stated:

*"The QCA recognises that mechanistically applying bottom-up assessment of individual WACC parameters will not necessarily ensure an appropriate overall WACC for Aurizon Network"*⁴

and reaffirmed this in its DAU2 Draft Decision:

"We had regard to both a bottom-up assessment of individual WACC parameters and the overall reasonableness and appropriateness of the resulting WACC. While a bottom-up assessment provides a means for assessing an appropriate rate of return for Queensland Rail, an ultimate consideration is whether the overall WACC is appropriate, having regard to all of the relevant factors in s. 138(2) of the QCA Act."

In these decisions, the QCA has demonstrated a willingness to consider alternative approaches to calculating the WACC. However, the QCA's treatment of other regulators' methodologies focused on component elements of the WACC rather than the overall rate of return. Queensland Rail believes that the QCA should undertake a 'top down' systematic examination of the rate of return methodologies adopted by other regulators and their assessment of the required compensation for the risk of investing in rail infrastructure, to further assist in the assessment of whether the overall DAU2 WACC is appropriate, having regard to all of the relevant factors in s. 138(2) of the QCA Act.

Independent Pricing and Regulatory Tribunal (IPART)

Table 1 shows how the IPART WACC methodology would affect Queensland Rail's rate of return. Each of the market parameters have been estimated according to IPART's methodology, however, the business specific parameters (i.e. equity beta, gearing and the relevant credit rating) from the DAU2 Draft Decision have been maintained. This results in a WACC of 7.28 per cent, 1.26 percentage points above the DAU2 Draft Decision WACC.

Table 1: Adopting IPART's methodology with the QCA's business specific parameters

WACC component	QCA Draft Decision on DAU2	IPART methodology, QCA parameters
Cost of debt		
Risk-free rate	2.28%	3.15%
Debt risk premium	2.28%	2.50%
Debt refinancing costs	0.108%	a
Return on debt	4.67%	5.65% ^b
Cost of equity		
Risk-free rate	2.28%	3.15%
Market risk premium	6.50%	7.30%
Equity beta	0.71	0.71
Return on equity	6.92%	8.36%
Gearing		
Debt proportion	40%	40%
Equity proportion	60%	60%
WACC	6.02%	7.28%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The IPART parameters are taken from its February 2017 WACC parameter update, see: IPART, WACC biannual update, February 2018.

a IPART allows debt refinancing costs of 12.5 basis points. However, its illustrative calculation of the WACC suggests it is incorporated into the debt risk premiums, ie, it does not have its own line item in the calculation.

b Noting that IPART would update the cost of debt annually throughout the regulatory period.

IPART is required to review the rate of return for NSW rail networks operated by RailCorp, which provide passenger train services, coal transportation and other freight services. The Australian Competition and Consumer Commission (**ACCC**) is responsible for the ARTC network in the Hunter Valley. The IPART review is undertaken every five years, with the draft decision on the latest review published in April 2019.

Adopting the 2019 IPART draft decision parameters Table 2 demonstrates the effect that adopting IPART's assessment of rail risk characteristics would have on Queensland Rail's WACC, relative to the QCA bottom-up approach in the DAU2 Draft Decision. Two alternative estimates have been calculated:

- Queensland Rail's potential WACC maintaining the QCA's methodology while adopting IPART's rail parameters; and
- Queensland Rail's potential WACC when adopting IPART's overall rate of return methodology (i.e. adopting IPART's calculation of market-based parameters as well as the business specific parameters).

⁴ QCA Fact Sheet: Aurizon Network's 2017 Draft Access Undertaking: Weighted Average Cost of Capital (WACC), <http://www.qca.org.au/Rail/Aurizon/Intro-to-Aurizon/UT5/Final-Report/2016-DAU>

Table 2: Impact of adopting IPART's rail parameters and overall rate of return methodology on Queensland Rail's WACC

WACC component	QCA Draft Decision on DAU2	QCA methodology, IPART parameters	Overall rate of return
Cost of debt			
Risk-free rate	2.28%	2.28%	3.15%
Debt risk premium	2.28%	2.28%	2.50%
Debt refinancing costs	0.108%	0.108%	a
Return on debt	4.67%	4.67%	5.65%b
Cost of equity			
Risk-free rate	2.28%	2.28%	3.15%
Market risk premium	6.50%	6.50%	7.30%
Equity beta	0.71	1.00	1.00
Return on equity	6.92%	8.78%	10.45%
Gearing			
Debt proportion	40%	45%	45%
Equity proportion	60%	55%	55%
WACC	6.02%	6.93%	8.29%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The IPART parameters are taken from its February 2017 WACC parameter update, see: IPART, WACC biannual update, February 2018.

a IPART allows debt refinancing costs of 12.5 basis points. However, its illustrative calculation of the WACC suggests it is incorporated into the debt risk premiums, i.e. it does not have its own line item in the calculation.

b Noting that IPART would update the cost of debt annually throughout the regulatory period.

Australian Competition and Consumer Commission (ACCC)

Table 3 shows how the ACCC's WACC methodology would affect Queensland Rail's rate of return. Note that the QCA in its DAU2 Draft Decision adopted an identical methodology to the ACCC in estimating the risk-free rate and debt risk premium. Accordingly, for this analysis Queensland Rail has adopted the QCA's estimates of these parameters when examining the impact of the ACCC's methodology. Further, the business specific parameters (i.e. equity beta, gearing and the relevant credit rating) have been maintained from the QCA's DAU2 Draft Decision.

Table 3: Adopting the ACCC's methodology with the QCA's Queensland Rail business specific parameters

WACC component	QCA Draft Decision on DAU2	ACCC methodology, QCA parameters
Cost of debt		
Risk-free rate	2.28%	2.28%
Debt risk premium	2.28%	2.28%
Debt refinancing costs	0.108%	0.095%
Return on debt	4.67%	4.66%
Cost of equity		
Risk-free rate	2.28%	2.28%
Market risk premium	6.50%	6.00%
Equity beta	0.71	0.71
Return on equity	6.92%	6.56%
Gearing		
Debt proportion	40%	40%
Equity proportion	60%	60%
WACC	6.02%	5.80%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019.

The ACCC released its draft decision on the ARTC Hunter Valley Coal Network (**HVCN**) in April 2017. Table 4 illustrates the effect of adopting the ACCC's methodology for calculating market-based parameters, as well as adopting their overall rate of return methodology. The table contains a comparison of:

- the QCA's DAU2 Draft Decision bottom-up approach for Queensland Rail;
- maintaining the QCA's WACC methodology but adopting the ACCC's business specific parameters; and
- adopting both the ACCC's methodology and business specific parameters (i.e. the overall rate of return).

Table 4: Impact of adopting the ACCC's rail parameters and overall rate of return methodology on Queensland Rail's WACC – HVCN draft decision

WACC component	QCA Draft Decision on DAU2	QCA methodology, ACCC parameters	Overall rate of return
Cost of debt			
Risk-free rate	2.28%	2.28%	2.28%
Debt risk premium	2.28%	2.28%	2.28%
Debt refinancing costs	0.108%	0.108%	0.095%
Return on debt	4.67%	4.67%	4.66%
Cost of equity			
Risk-free rate	2.28%	2.28%	2.28%
Market risk premium	6.50%	6.50%	6.00%
Equity beta	0.71	0.94	0.94
Return on equity	6.92%	8.39%	7.92%
Gearing			
Debt proportion	40%	52.5%	52.5%
Equity proportion	60%	47.5%	47.5%
WACC	6.02%	6.44%	6.21%

Source/notes: This table was prepared by HoustonKemp Economists. This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The ACCC's business specific parameters are taken from its draft decision regarding its ARTC HVCN draft decision, see: ACCC, Australian Rail Track Corporation's 2017 Hunter Valley access undertaking | Draft decision, 20 April 2017.

The ACCC draft decision on the ARTC interstate rail network was released in December 2018. Table 5 illustrates the effect of adopting the ACCC's ARTC interstate methodology for calculating market-based parameters, as well as adopting their overall rate of return methodology. The table contains a comparison of:

- the QCA's DAU2 Draft Decision bottom-up approach for Queensland Rail;
- maintaining the QCA's WACC methodology but adopting the ACCC's business specific parameters; and
- adopting both the ACCC's methodology and business specific parameters (i.e. the overall rate of return).

Table 5: Impact of adopting the ACCC's rail parameters and overall rate of return methodology on Queensland Rail's WACC – interstate draft decision

WACC component	QCA Draft Decision on DAU2	QCA methodology, ACCC parameters	Overall rate of return
Cost of debt			
Risk-free rate	2.28%	2.28%	2.28%
Debt risk premium	2.28%	2.28%	2.28%
Debt refinancing costs	0.108%	0.108%	0.095%
Return on debt	4.67%	4.67%	4.66%
Cost of equity			
Risk-free rate	2.28%	2.28%	2.28%
Market risk premium	6.50%	6.50%	6.00%
Equity beta	0.71	1.2	1.2
Return on equity	6.92%	10.08%	9.48%
Gearing			
Debt proportion	40%	50%	50%
Equity proportion	60%	50%	50%
WACC	6.02%	7.37%	7.07%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The ACCC's business specific parameters are taken from its draft decision regarding its ARTC interstate draft decision, see: ACCC, Australian Rail Track Corporation's 2018 Interstate Access Undertaking | Draft decision, 20 December 2018

Economic Regulation Authority of Western Australia (ERA)

The ERA is required under the *Railways (Access) Code 2000* to determine annually the long-term WACC to be applied in establishing the capital costs of the regulated railways. The ERA's current purview extends to Public Transport Authority Network, the Arc Infrastructure network (freight transportation) and the Pilbara Infrastructure Railways network (which links iron ore mines in the Pilbara to Port Hedland). The ERA makes a determination for each of these rail networks. However, for the purposes of this analysis the determination for the Public Transport Authority has not been considered because the public transport network is unlikely to be comparable to Queensland Rail's West Moreton system. Table 6 illustrates the effect of adopting the ERA's market parameter estimates while preserving the QCA's DAU2 Draft Decision business specific parameters.⁵

Table 6: Adopting the ERA's methodology with the QCA's business specific parameters

WACC component	QCA Draft Decision on DAU2	ERA methodology, QCA parameters
Cost of debt		
Risk-free rate	2.28%	2.76%
Debt risk premium	2.28%	1.97%
Debt refinancing costs	0.108%	0.10%
Return on debt	4.67%	4.83%
Cost of equity		
Risk-free rate	2.28%	2.76%
Market risk premium	6.50%	5.90%
Equity beta	0.71	0.71
Return on equity	6.92%	6.97%
Gearing		
Debt proportion	40%	40%
Equity proportion	60%	60%
WACC	6.02%	6.12%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The ERA's market parameters for each regulated railway have been drawn from its latest draft determination, see: ERA, 2018 weighted average cost of capital at 30 June 2018 for the freight and urban networks, and the Pilbara railways | Draft determination, 2 May 2019. The debt risk premium has been calculated as the average of Arc Infrastructure and Pilbara Railways to approximate the BBB rating (these rail operators have credit ratings of BBB+ and BBB- respectively)

Adopting the ERA's Rail Methodology and Parameters

The following tables illustrate the effect of adopting the ERA's methodology for calculating market-based parameters, as well as their rail specific business parameters. While each rail network regulated by the ERA is considered, the Pilbara Infrastructure Railways network is viewed as the most comparable to Queensland Rail. The basis of this view is that the sole function of the Pilbara rail network is to transport iron ore to the ports for export. This is analogous to Queensland Rail's primary role of transporting coal for export.

The tables show that the largest increase in Queensland Rail's WACC occurs when maintaining the QCA's methodology for market-based parameters while adopting the ERA's rail business specific parameters for Pilbara Railways (see Table 7). In particular, this approach leads to an increase of Queensland Rail's WACC of 3.50 percentage points, relative to the QCA's bottom-up estimate in the DAU2 Draft Decision. This increase is driven by the larger equity beta and the reduced level of gearing. While there is also a large increase in Queensland Rail's WACC adopting the ERA's overall rate of return methodology, the increase is more muted due to the lower MRP and therefore cost of equity.

Adopting the ERA's rail and market-based parameters for Arc Infrastructure also yields an increase in Queensland Rail's WACC (see Table 8). For instance, maintaining the QCA's methodology for market-based parameters while adopting the business parameters determined for Arc Infrastructure increases Queensland Rail's WACC by 1.24 percentage points, relative to the QCA's bottom-up estimate in the DAU2 Draft Decision. This in the bottom-up WACC is 1.17 percentage points when adopting the ERA's overall rate of return methodology. The drivers of these increases are analogous to those discussed in relation to Pilbara Infrastructure Railways network. However, the increase is more muted given that Arc Infrastructure has a lower equity beta and a higher degree of gearing.

⁵ Note that since the ERA determines different credit ratings for each regulated railway, market driven parameters such as the debt risk premium differ across each regulated rail operator. To generate a single estimate, the debt risk premium has been calculated as equal to the average of that for Arc Infrastructure and Pilbara Railways. This calculation is done to approximate a BBB rating, since these railways have credit ratings of BBB+ and BBB- respectively.

Table 7: Impact of adopting the ERA's rail parameters and overall rate of return methodology on Queensland Rail's WACC – 2018 Pilbara draft decision

WACC component	QCA Draft Decision on DAU2	QCA methodology, ERA parameters	Overall rate of return
Cost of debt			
Risk-free rate	2.28%	2.28%	2.76%
Debt risk premium	2.28%	2.28%	2.24%
Debt refinancing costs	0.108%	0.108%	0.100%
Return on debt	4.67%	4.67%	5.10%
Cost of equity			
Risk-free rate	2.28%	2.28%	2.76%
Market risk premium	6.50%	6.50%	5.90%
Equity beta	0.71	1.3	1.3
Return on equity	6.92%	10.73%	10.43%
Gearing			
Debt proportion	40%	20%	20%
Equity proportion	60%	80%	80%
WACC	6.02%	9.52%	9.36%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The ERA's business and market parameters have been drawn from its latest rail draft determination, see: ERA, 2018 weighted average cost of capital at 30 June 2018 for the freight and urban networks, and the Pilbara railways | Draft determination, 2 May 2019

Table 8: Impact of adopting the ERA's rail parameters and overall rate of return methodology on Queensland Rail's WACC – 2018 Arc Infrastructure draft decision

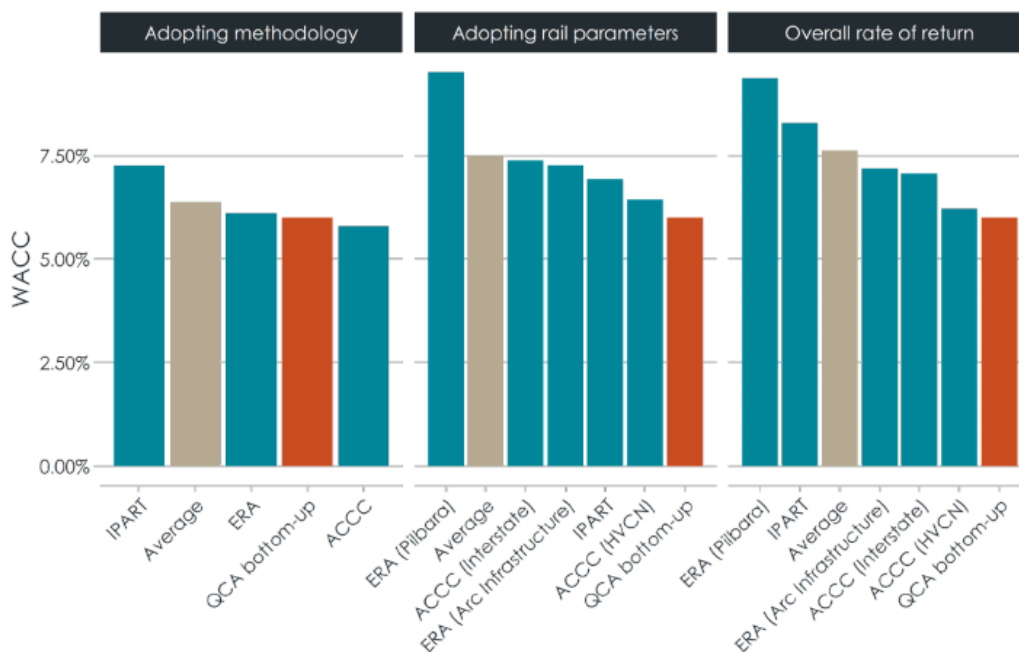
WACC component	QCA Draft Decision on DAU2	QCA methodology, ERA parameters	Overall rate of return
Cost of debt			
Risk-free rate	2.28%	2.28%	2.76%
Debt risk premium	2.28%	2.28%	1.69%
Debt refinancing costs	0.108%	0.108%	0.100%
Return on debt	4.67%	4.67%	4.55%
Cost of equity			
Risk-free rate	2.28%	2.28%	2.76%
Market risk premium	6.50%	6.50%	5.90%
Equity beta	0.71	0.9	0.9
Return on equity	6.92%	8.13%	8.07%
Gearing			
Debt proportion	40%	25%	25%
Equity proportion	60%	75%	75%
WACC	6.02%	7.26%	7.19%

Source/notes: This table was prepared by HoustonKemp Economists. The QCA's bottom-up approach parameters are drawn from the Queensland Rail draft decision, see: QCA, Queensland Rail's 2020 Draft Access Undertaking | Draft decision, April 2019. The ERA's business and market parameters have been drawn from its latest rail draft determination, see: ERA, 2018 weighted average cost of capital at 30 June 2018 for the freight and urban networks, and the Pilbara railways | Draft determination, 2 May 2019

The analysis in this submission suggests that a 'top down' review of alternative WACC methodologies in totality would reveal that the QCA's current methodology results in a lower rate of return for Queensland Rail than for comparable networks. This submission demonstrates that the QCA's bottom-up estimate results in a WACC that lies at the bottom of the range of WACCs estimated when drawing upon other regulators' rail parameters and their methodology.

Queensland Rail also notes that the QCA is currently considering an agreement between Aurizon Network and its stakeholders to increase the UT5 WACC from 5.7% to 5.9% with effect from 3 May 2019, rising to 6.3% on completion of initial capacity assessment report. If approved, this will result in the Aurizon Network WACC being materially higher than the QCA's proposed DAU2 WACC leaving Queensland Rail at the lower end of the spectrum. Figure 1 summarises the Queensland Rail's top down analysis for the QCA's consideration. Queensland Rail seeks that the QCA reassess the suitability of the DAU2 WACC taking into account this analysis.

Figure 1: Comparison of WACC methodologies



2.4 The Systra Report

Overall Queensland Rail is supportive of the SYSTRA Report and Queensland Rail accepts in principle SYSTRA's recommendation that there be some trade-off between resurfacing and formation build.

The SYSTRA report recommended a 209km annual reduction of resurfacing from 432.425km per annum to approximately 223km per annum. The recommendation was premised on SYSTRA's recommendation of a formation rebuild strategy. The concept of the strategy is to rebuild the formation in the first three years of the DAU2 term at locations that have historically required three or more resurfacings with SYSTRA recommending the DAU2 program include the additional formation rebuild outlined in Table 9:

Table 9 SYSTRA's Recommended Additional Formation Rebuild

Year	km	Additional Formation (km)	Cumulative linear distance (km) potential reduction in resurfacing
Year 1	0.326 km of sites that required six resurfacings	0.326	1.956
Year 1	2.964 km of sites that required five resurfacings	2.964	14.820
Year 1	3.046 km of sites that required five resurfacings	3.046	15.230
Year 2	4.474 km of sites requiring three resurfacings	4.474	13.422
Year 3	3.806 km of sites requiring two resurfacings	3.806	7.612
	Total	14.616	53.040

Adopting SYSTRA's formation rebuild strategy would not result in a 209km annual reduction in resurfacing as outlined in the SYSTRA Report. Rather, the potential reduction is up to 53.040km in resurfacing per annum. Queensland Rail estimates that the DAU2 resurfacing costs would be [REDACTED] rather than the [REDACTED] in the SYSTRA Report (refer Table 10).

Table 10: Revised Estimated Resurfacing Costs Under the SYSTRA Strategy

Resurfacing	2020/21	2021/22	2022/23	2023/24	2024/25	Total DAU2
Jondaryan - Columboola	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Rosewood - Jondaryan	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

On this basis, Queensland Rail proposes that the DAU2 resurfacing budget for the DAU2 period be decreased from [REDACTED] to [REDACTED].

While Queensland Rail supports in principle some rebuilding of formation to provide a long term lower resurfacing costs as suggested by SYSTRA, The QCA must take care and recognise that SYSTRA provided the formation repair versus resurfacing trade off as an example strategy only, not a recommended outcome:

*"The formation rebuild strategy provided by SYSTRA is an example only. SYSTRA acknowledges the complexity of this challenge; particularly over the expansive black soils and the nature of development of some of these failure sites. SYSTRA also acknowledges that other methods exist to address these issues such as lime stabilisation, geocells or slotted aggregate filled trench drains perpendicular to the formation."*⁶

Further, Queensland Rail notes that no justification has been provided for the complete removal of the \$9.5M in track lowering costs. Queensland Rail believes that this is required and should remain included in the reference tariff works.

2.1mtpa Scenario

The DAU2 Draft Decision assumes a 9.1mtpa higher tonnage scenario, as Queensland Rail did not formally submit the lower 2.1mtpa lower tonnage scenario for approval. However, as Queensland Rail had provided the relevant information, the QCA consultants SYSTRA have made an assessment of the 2.1mtpa scenario. Queensland Rail notes that QCA consultant SYSTRA considers overall:

*"In terms of current asset condition the Queensland Rail engineering team are doing a good job of maintaining this challenging rail within the prescribed CETS track geometry limits."*⁷

The main area of difference as acknowledged by SYSTRA in its report is that SYSTRA's analysis of the 2.1mtpa scenario was not like for like with that submitted by Queensland Rail:

"Queensland Rail's view of the 2.1 mtpa scenario is that it would only be a temporary situation and that either an existing coal producer or a new producer would require tonnages to increase back towards 9.1 mtpa. SYSTRA, on the other hand, analysed the 2.1 mtpa scenario as a medium to long term situation."

That is, the SYSTRA approach is based upon NAS3 not being approved, and the network being maintained at a level that accommodates no more than the lower tonnage scenario. Queensland Rail's approach is to maintain the

⁶ SYSTRA Scottlister, Queensland Competition Authority: Queensland Rail West Moreton System Review of Proposed Maintenance, Capital & Operations Expenditure Draft Access Undertaking 2 (DAU2), p.104

⁷ SYSTRA Scottlister, Queensland Competition Authority: Queensland Rail West Moreton System Review of Proposed Maintenance, Capital & Operations Expenditure Draft Access Undertaking 2 (DAU2), p.10

reliability of the network to a level sufficient to accommodate New Hope railings with NAS3. Queensland Rail considers that it is prudent to undertake capital expenditure (such as timber bridge replacement) even if volumes are lower, which also minimises the potential impact on future available capacity. This avoids the need to undertake additional 'catch-up' capital expenditure when tonnages are closer to maximum capacity, also causing delays.

If Queensland Rail developed a lower tonnage scenario on the basis of volumes on the West Moreton System being low indefinitely similar to SYSTRA, this would require Queensland Rail to reconsider its asset management strategy.

2.5 Loss Capitalisation

There remains considerable uncertainty as to whether New Hope will receive the required approvals for NAS3. Without NAS3 there will be only one mine operating on the West Moreton System, Cameby Downs, railing [REDACTED] of coal.

Not a New Concept

It is within this climate that Queensland Rail supports a loss capitalisation approach if the lower tonnage scenario eventuates. The ACCC noted with respect to the use of a loss capitalisation model in the Hunter Valley:

"The intent of loss capitalisation is to allow under-recovery of economic cost for a period and then recovery of the relevant shortfall at a later date. In appropriate circumstances, loss capitalisation may therefore operate to facilitate investment in new assets where there is limited initial demand by allowing initial under-recovery of relevant costs in the expectation of 'making up' the shortfall when demand reaches an appropriate level."

Maintaining a regulatory approved loss capitalisation account is not a new concept, with various mechanisms also applying to NBN Co, Central west pipeline, State Water (NSW) and Aurizon (Deferred Depreciation, Goonyella to Abbot Point Expansion).

Loss Capitalisation Principles

Queensland Rail proposes a loss capitalisation approach that retains the current overall building block methodology, producing a ceiling reference tariff at the lower tonnage level of [REDACTED]. Queensland Rail acknowledges that this ceiling reference tariff may not be affordable for Yancoal. Queensland Rail therefore proposes that an affordable reference tariff, based upon Yancoal's ability to pay, be approved by the QCA in addition to the ceiling reference tariff.

While the affordable reference tariff is in place, revenue foregone on the system would be added to a separate 'Loss Capitalisation' book, accruing each year (netting off the affordable reference tariff against the ceiling reference tariff). The affordable reference tariff should be equitable for current and future access seekers and provide incentive for future expansion. Loss capitalisation should provide pricing certainty for access holders and access seekers at the time of approval by the QCA, and not act as a disincentive to future access seekers. Foregone revenue would begin to be recovered from all coal traffic operating on the system once an increase in tonnes occurs through NAS3 approval. When the losses have been recovered, the repayment premium would be removed from the new access charge.

In this scenario, it must be recognised that Queensland Rail would bear all of the risk of NAS3 not progressing, as a loss capitalisation approach would then become redundant unless Columboola sufficiently expands, or another viable mine commences operation.

Loss capitalisation will enable Queensland Rail to recover its efficient costs over the long term, consistent with the requirements of the QCA Act. Access holders will pay the efficient cost of using the service at affordable rates. A lengthy and complex asset optimisation review will not be required and recovery over the longer term will ensure that the reference tariff provides the right incentive and that everyone remains whole.

New Hope (and new access seekers) will have the benefit of Queensland Rail being in a position to keep the network at an infrastructure level that will enable operations to begin immediately once any approvals are granted, rather than a minimum maintenance approach at the [REDACTED]. Future access seekers will benefit from current investment.

Queensland Rail will propose a more detailed recovery mechanism once the prospects of NAS3 proceeding become more clear.

DAU2 Draft Decision

Queensland Rail acknowledges and supports the QCA's willingness to consider a loss capitalisation approach.

However, Queensland Rail considers that the loss recovery premium of 15% on contracted paths proposed in the DAU2 Draft Decision is arbitrary and insufficient. Also, the current reference tariff should not be the benchmark of affordability simply because that is the amount currently being paid. Previously the reference tariff was considerably higher, while at the same time New Hope was seeking approval of the NAS3 mine expansion. Further, the current reference tariff was developed based upon an incorrect assumption that there was an 87 Train Path Constraint through the Metropolitan System. Queensland Rail considers that the affordable reference tariff must be developed after an objective assessment of the efficient costs of providing the service, an appropriate return, and ability to pay.

In particular, the QCA should assess how much thermal coal prices have increased since the time of the AU1 Final Decision and the coal price outlook over the DAU2 period.

Queensland Rail acknowledges the QCA’s request for further submissions on access holders’ willingness to pay and considers that this assessment is essential to the development of an affordable reference tariff:

“We are interested in stakeholders’ views on whether the current price provides a reasonable indication of access seekers and holders’ willingness to pay, and how that information can be appropriately addressed when assessing the West Moreton coal reference tariffs at low volumes.”⁸

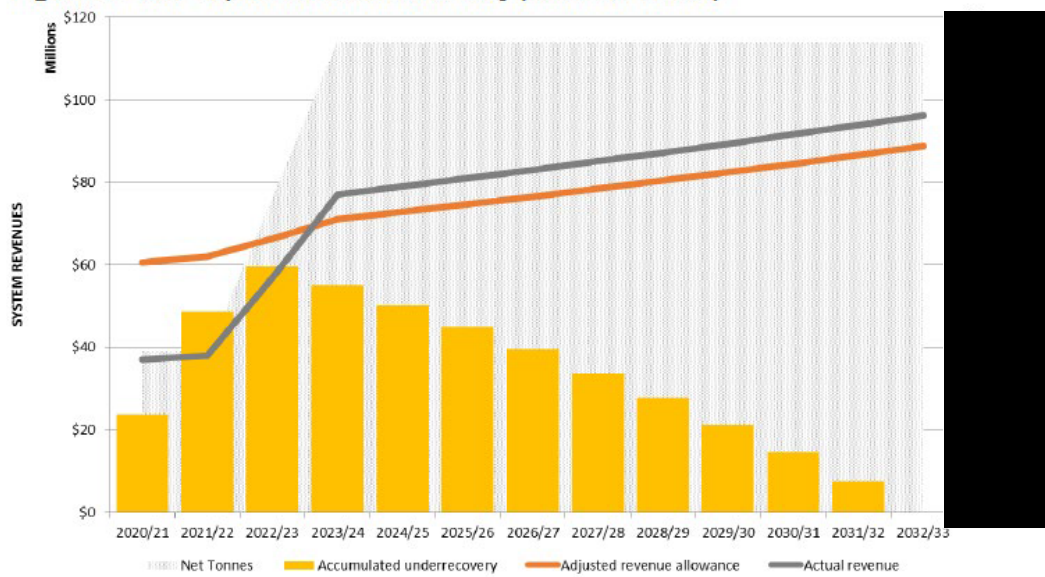
Queensland Rail also has concerns with the proposal in the Draft Decision that each under- or over-recovery would remain at full value for five years, after which it would be fully depreciated over the next five years (i.e. the account “begins to depreciate at 20 per cent per annum”). Proper modelling is first required to determine the effect of NAS3 railings on the overall reference tariff, rather than arbitrarily assuming in the first instance that ‘very large losses’ will accumulate, or that losses must remain unpaid and be depreciated. Assuming NAS3 progresses, and operations commence during the term of DAU2, once the NAS3 tonnages are railing there will be no further accumulation of losses and repayment will commence.

Queensland Rail believes that a longer period of recovery, if required, will ensure that Queensland Rail recovers its legitimate efficient costs and an appropriate return, the users of the service will pay the legitimate costs of using the service and will maintain a mechanism that does not discourage future access seekers or investment in the network, consistent with the requirements of the QCA Act. Queensland Rail does not believe that the approach proposed in the DAU2 Draft Decision achieves this, or that it is consistent with loss capitalisation precedent in other regulatory regimes. Queensland Rail encourages an approach which keeps everyone whole.

Loss Capitalisation Example

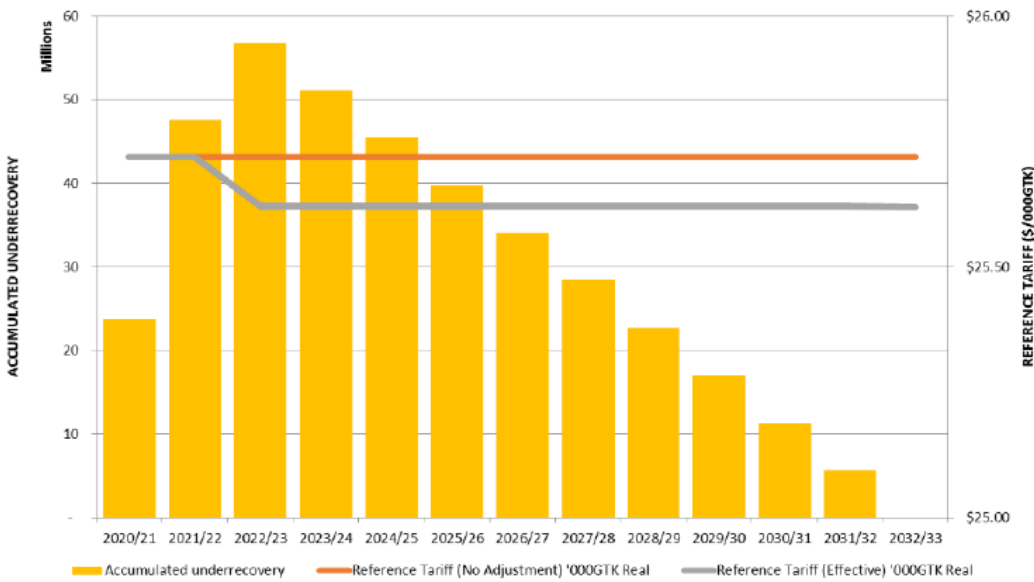
The figures below demonstrate how the Loss Capitalisation principles would apply at a proposed minimum opening access charge of \$25.72 /000 gtk at the start of DAU2, based on the recast [redacted] building block assumptions and revised system throughput forecasts over the DAU2 term. In this scenario NAS3 begins railings at [redacted] halfway through the DAU2 term (i.e. 1 January 2023).

Figure 2: Loss Capital Revenue Recovery (Nominal Terms)



⁸ DAU2 Draft Decision p.63

Figure 3: Loss Capital Revenue Recovery (Real Terms)



Notes:

1. The \$25.72 /000gtk represents all costs for the system at [redacted] excluding Rosewood to Jondaryan capital costs (the shared component)
2. Losses are accumulated from the shared Rosewood to Jondaryan capital cost component in New Acland’s absence.
3. Actual revenue overtakes the adjusted lower revenue allowance, assuming NAS3 volumes commence mid-way through the DAU2 term. A repayment premium is attached to the revised access charge (in this example 8.5% of the revised nominal access charge \$24.81 /000gtk equating to a premium of \$2.11 /000gtk \$2022/23).
4. The difference between the two revenue streams begins to reduce the accumulated losses over time.
5. The opening access charge drops in 2022/23 from a nominal \$27.02 /000gtk to \$26.92 /000gtk (for Cameby Downs effective \$14.97 /nt to \$12.41 /nt) with the re-socialised system enabling full system cost recovery.
6. The fall in price preserves incentive to increase volumes to lower unit rate costs.
7. Under the scenario conditions, the accumulated loss account is exhausted after 10 years and the Loss Capitalisation book is closed.
8. Prices exclude Brisbane Metropolitan reference tariff costs
9. The system access charge drops slightly in 2032/33 with both Cameby Downs and NAS3 volumes enabling full system recovery over the period.
10. Once the losses have been recovered (end 2032/33), the repayment premium is removed from the access charge.

2.6 Cameby Downs Ability to Pay – Low Tonnage Scenario

The QCA sought stakeholder submissions on Yancoal’s (Cameby Downs) ability to pay at the lower tonnage scenario.⁹ To ascertain an affordable reference tariff for Cameby Downs for the DAU2 period, Queensland Rail has undertaken analysis of the mine’s estimated cost base compared to forecast coal prices. Queensland Rail has used independent mine cost data and forecasts from AME Advisory for the West Moreton System, together with Queensland Rail’s estimates of above rail costs and coal royalties. Queensland Rail has used an average thermal coal spot price of \$96 (AUD) (assuming a 0.77 USD to AUD exchange rate) over the period, which is consistent with forecasts published by the Department of Industry, Innovation and Science and KMPG. This analysis is presented in Table 11 demonstrating Cameby Downs “below rail affordability”.

Table 11: Cameby Downs Below Rail Affordability Analysis \$(AUD) per net tonne

	Year 1	Year 2	Year 3	Year 4	Year 5
	2020/21	2021/22	2022/23	2023/24	2024/25
Revenue					
Coal Price (\$NT) ¹	\$96.10	\$96.10	\$96.10	\$96.10	\$96.10
Less Costs					
Mining cost (\$NT)	32.66	33.55	34.27	34.60	35.06
Processing cost (\$NT)	4.90	4.91	4.94	4.95	4.96
Admin & Support (\$NT)	3.75	3.84	3.91	3.95	4.00
Sub- Total FOR²	\$41.31	\$42.30	\$43.12	\$43.49	\$44.03
Above Rail cost (\$NT) ³	17.00	17.43	17.86	18.31	18.76
Port Handling Charges (\$NT)	6.81	6.88	6.97	7.05	7.14
Royalties (\$NT) ⁴	7.00	7.00	7.00	7.00	7.00
On + Offsite costs (FOB Cash Cost excl. Below Rail)	\$72.12	\$73.61	\$74.95	\$75.85	\$76.93
Sub-Total Below Rail Affordability	\$23.98	\$22.49	\$21.15	\$20.25	\$19.17

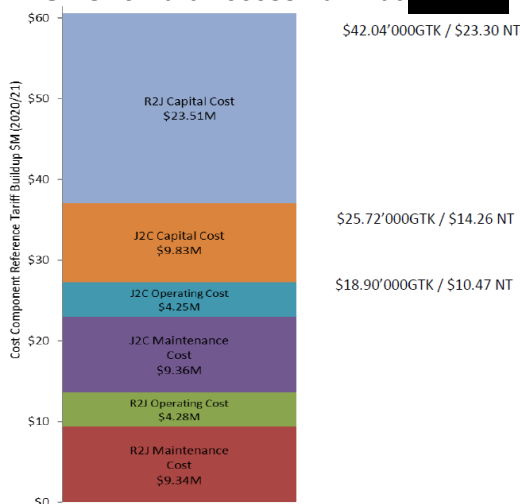
Notes:

1. Coal price derived from the Office of the Chief Economist for the Department of Industry, Innovation and Science’s December 2018 Quarterly Update.
2. Mine cost data, estimated port costs and forecasts sourced from May 2018 AME Advisory report for the West Moreton system
3. Above Rail cost estimated by Queensland Rail modelling.
4. Royalties charge estimated based on the royalty rate payable under the Mineral Resources Regulation 2013 (Qld).

⁹ DAU2 Draft Decision p.63

Figure 4 below shows the estimated one-part access tariff cost component build-up at a [REDACTED] throughput. It is noted the cost component build up that includes all maintenance and operating costs plus return on and of capital for the Jondaryan to Columboola (Cameby Downs) section equates to \$14.26 per net tonne (West Moreton only). DAU2 costs have been used.

Figure 4: \$2020/21 AU2 One-Part Access Tariff at [REDACTED] (excluding Metro)



Adding the equivalent Metropolitan System Access Tariff estimate of \$2.55 per net tonne (\$2020/21) the total estimate charge equates to \$16.81 per net tonne. Table 12 demonstrates how this net tonne equivalent affects the profitability of the Cameby Downs mine relative to its below-rail affordability estimate. The reducing profitability is due to the constant coal price assumption, whereas all other costs, excluding royalties, are escalating at CPI.

Table12: Cameby Downs Profitability Analysis \$(AUD) per net tonne

	Year 1	Year 2	Year 3	Year 4	Year 5
	2020/21	2021/22	2022/23	2023/24	2024/25
Sub-Total Below Rail Affordability	23.98	22.49	21.15	20.25	19.17
Below Rail cost (\$NT)	16.81	17.23	17.66	18.10	18.55
Mine Profit (\$NT)	\$7.17	\$5.26	\$3.49	\$2.15	\$0.62

As the mine is forecast to remain profitable, and Queensland Rail’s cash costs and certain capital costs are met upfront, Queensland Rail proposes a below ceiling affordable reference tariff of \$25.72 per 000 gtk (2020-21 \$s) at the [REDACTED] system throughput based upon ‘ability to pay’.

2.7 Cost allocations

The DAU2 Draft Decision appears to indicate that the QCA is considering changing its approach to cost allocation by allocating costs only to contracted coal train paths, leaving Queensland Rail to fund most of the costs of the system:

*“We have not seen evidence of coal services contracting above the 87-train-path constraint; therefore, we consider removing the constraint when assessing the reference tariff to be premature. Indeed, as New Hope said¹⁹, given that coal miners’ investment decisions were affected when the constraint was applied a decade ago, **it may be appropriate only to remove the constraint when there is actual contracting above 87 paths.**” (emphasis added)¹⁰*

This would be a significant move from the QCA’s Final Decision on AU1. For example, the 2016 Final Decision stated:

*“We considered that coal traffics should only pay for efficient fixed common network costs that reflected the proportion of paths **available for contracting by coal services.**”¹¹ (emphasis added)*

This approach was not foreshadowed in and is not consistent with the reasoning advanced by the QCA in its Final Decision on AU1, and may be perceived as designed to permit the QCA to move the parameters removing regulatory certainty, ensuring that Queensland Rail cannot recover a greater proportion of costs than permitted under AU1, thereby continuing to prevent Queensland Rail from recovering its efficient costs of providing the West Moreton System service.

¹⁰ DAU2 Draft Decision, p.11

¹¹ Decision: Queensland Rail’s Draft Access Undertaking June 2016, p.122

Importantly, there is no evidence that miners' investment decisions have been based upon an 87 Train Path Constraint. To the contrary, New Hope first applied for regulatory approvals for the NAS3 expansion in 2007. New Hope has only recently [REDACTED], [REDACTED], not any perceived 87 Train Path Constraint.

In addition, Yancoal has recently received approval to expand from [REDACTED] to [REDACTED]. In total, New Hope's [REDACTED] with Yancoal's [REDACTED] would result in capacity requirements of [REDACTED], which is near the capacity of the West Moreton System, and well above the 87 Train Path Constraint. It is clear that an alleged 87 Train Path Constraint has played no role in investment decisions.

The QCA must base decisions on objective facts and not unsupported assertions from stakeholders.

The 87 Train Path Constraint was only proposed by TMR in 2011 and TMR has advised the QCA that the constraint was removed by 2015. Lower contracting since 2012 has been due to low world thermal coal prices and New Hope's inability to obtain NAS3 approvals, not to a perception of an 87 Train Path Constraint. No access requests have been refused on the basis of an 87 Train Path Constraint.

Additionally, Queensland Rail is receiving an increased number of access requests, with already contracted paths and new access requests totalling [REDACTED] coming from three mines, New Acland, Columboola and North Surat. This translates to well in excess of the current 97 weekly return services and demonstrates that there has been no effect on investment. Queensland Rail has advised industry that the system capacity can also be expanded for coal through its master planning process.

The allocation of common West Moreton System network costs based on 97 out of 113 paths (i.e. 86%) is also reasonable considering that in 2017-18 coal trains accounted for 95% of the paths used and 98% of net tonnes and 98% of gtk's transported in system as shown in Table 13.

Table 13: West Moreton Network Utilisation 2017-18

Train Type	Available Train Paths Return Per Week		One Way Train Paths Used in 2017-18		Net Tonnes (000s) 2017-18		gtk (millions) 2017-18	
Coal	97	86%	7095	94%	6439	98%	2439	98%
Non Coal Freight	14	12%	181	2%	124	2%	40	2%
Passenger/Charter	2	2%	234	3%	0	0%	15	1%
Total	113		7510		6563		2494	100%

Source: Queensland Rail's Access Undertaking 1 - 2017-18 Annual Performance Report - 13 December 2018

Finally, in a low tonnage scenario, a loss capitalisation methodology will ensure that all parties will be sufficiently protected.

2.8 Systemic Risk

NAS3 Assumption

In assessing the West Moreton System WACC, QCA consultants Incenta have first assumed that that NAS3 will be approved:

*"We note that QR-Coal has only two customers, New Hope Group (New Hope) and Yancoal, compared with Aurizon Network's more than 40 customers. At the time of writing this report New Hope's proposed New Acland mine development has not been approved. Together with Yancoal's 2.1 mtpa would result in the full utilisation of QR-Coal's approximately 9 mtpa capacity. For the purposes of this report we have assumed that this uncertainty has been resolved, that New Hope proceeds with its development, and has take-or-pay contracts covering the vast majority of its component of the capacity."*¹²

However, the reality is that it remains uncertain as to whether NAS3 will progress. In an accurate assessment this uncertainty would have had a fundamental effect on the outcome of Incenta's review. Even if NAS3 does progress, the true risk of this uncertainty should be taken into account.

Systemic Risk - Closure of Wilkie Creek

Queensland Rail believes that the QCA should give further consideration to systemic risk arising from changes in international coal prices. For example, Peabody suspended operations at the Wilkie Creek mine in 2013 and de-commissioned the mine after it was unsuccessful in its efforts to sell.¹³ International thermal coal prices were the determinative factor in Peabody's closure of the Wilkie Creek mine:

- The PwC August 2016 Report states that 'with the reduction of the international coal prices, the Wilkie Creek Mine was closed late in 2013'.¹⁴

¹² Incenta Economic Consultants, Estimating Queensland Rail's WACC for the 2020 DAU – asset beta, benchmark gearing, and credit rating Report for the QCA April 2019 p. 2

¹³ A proposed sale to Exergen in July 2015 did not complete (South West Producers July 2018 Submission, page 21).

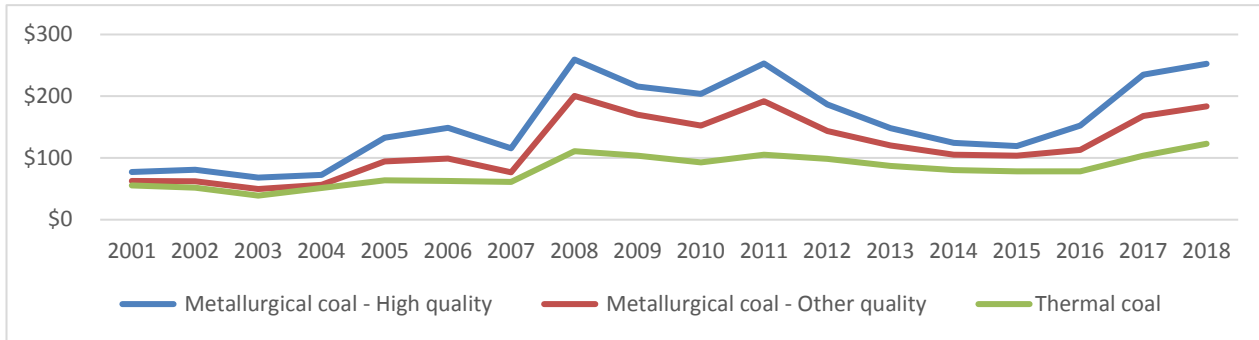
¹⁴ PwC, Queensland Regional Rail Network Review, Freight Logistics Chains Working Paper, August 2016, page 10.

- The Australian newspaper came to the same conclusion, commenting that the closure was due to falling coal prices, the carbon tax and other cost increases. The same article includes quotes from a Peabody spokesperson who stated:¹⁵

“the decision to close Wilkie Creek has been made in response to a broad combination of lower market prices and higher costs”, she added, “whilst the carbon tax was not a primary cause of the closure, it represents a substantial burden on an export-driven mine.”

The export price for thermal coal is set out in Figure 5.¹⁶

Figure 5: Export value of different types of coal products (\$AUD per tonne)



2.9 Ad Hoc Path Tariff Premium

Queensland Rail supports the DAU2 Draft Decision that a premium charge apply to ad hoc coal train paths on the West Moreton System to encourage access holders to contract coal paths.

2.10 Capital expenditure approval process (schedule E)

In AU1 and Aurizon’s UT5 the QCA undertakes an annual assessment of prudence of and approval of capital commissioned by the service provider in a subject year, for inclusion in the regulatory asset base. This annual assessment mitigates capital expenditure risk. However, the DAU2 Draft Decision proposes that no prudence assessment of AU1 West Moreton reference capital expenditure program take place until 2025, at the end of the five year term of AU1.

Queensland Rail does not support this DAU2 Draft Decision proposal. An annual process is more efficient. In the event the QCA determines that expenditure is not prudent, Queensland Rail has an opportunity to address its processes. It places an unnecessary level of stranding risk upon Queensland Rail with the entire, substantial capital program assessed after five years and is contrary to the more reasonable approach adopted in UT5 and AU1.

3. Standard Access Agreement

The QCA proposed several changes to the form of standard access agreement submitted by Queensland Rail. These include changes not proposed by Queensland Rail, to provisions that the QCA considered it appropriate to approve as recently as 2016.

Queensland Rail is consulting with stakeholders on a number of proposed changes to the SAA, and will submit a marked-up version of the documents including any agreed variations after the collaboration period. In addition, Queensland Rail makes the following submissions on other issues raised by the QCA.

Process for granting operational rights to train operators and the nomination of subsequent operators (clause 1.3)

The standard access agreement is not a retail consumer contract. It is not necessary for the QCA to seek to provide legal advice or impose its preferred drafting on well-represented commercial parties.

Five tripartite access agreements in the form submitted have been agreed and executed to date – being one hundred percent of tripartite access agreements entered.

Change to interface risk management plan (clause 9.2(d))

The QCA proposes to replace the word “notices” with the word “communications” in this clause. Queensland Rail does not support this change. Amendments to the contract are a matter between the parties. This proposed amendment is of a minor and inconsequential nature, as defined in section 138(6) of the QCA Act.

¹⁵ Matt Chambers, The Australian, *High costs shut Wilkie Creek*, 10 December 2013, <<https://www.theaustralian.com.au/national-affairs/climate/high-costs-shut-wilkie-creek/news-story/d7e2fb9e903cedb0e2d6d0cad3bc98ea>>.

¹⁶ Prepared by HoustonKemp Economists

Changes to rail safety legislation (clauses 9.3, 9.10, 10.1, 28.1)

The QCA considers it appropriate to amend the definition of RSNL to reflect that the Queensland and South Australian laws are separate acts and to refer to the South Australian National Law.

While the Rail Safety National Law (RSNL) was first enacted in South Australia - each state and territory has passed a law explaining that the RSNL (being the schedule to the South Australian law) is the rail safety law in that state or territory or replicates that law.

The RSNL is applied (with modifications) as a law of Queensland by the *Rail Safety National Law (Queensland) Act 2017*. The *Rail Safety National Law (Queensland)* is the law as it applies in Queensland (section 4 - *Rail Safety National Law (Queensland) Act 2017*).

Noise mitigation disputes (clause 12.2) and other disputes

Contractual parties are the best placed to determine the best forum for resolution of contractual disputes. However, Queensland Rail has no objection to expert determination, provided the parties are not restricted from referring matters to a court where any considers it appropriate to do so.

Performance Levels (clause 13.4(a))

The QCA's proposal is simply a matter of drafting and is unnecessary. Queensland Rail's proposed clause 13.4(a)(iv) clearly gives the parties to the agreement the flexibility to agree penalties for failure to meet performance levels, as the parties to the agreement consider appropriate. The drafting adopted reflects discussions between Queensland Rail and stakeholders prior to the submission of DAU2. Any amendments to reflect specific agreements about performance levels are a matter between the parties. This proposed amendment is of a minor and inconsequential nature, as defined in section 138(6) of the QCA Act.

Relinquishment Fees (clause 21.2(c))

The terms of an access agreement are always a matter for commercial negotiation. However, there is no justification for adopting a different approach to relinquishment fees in an approved standard agreement as between reference tariff and non-reference tariff services.

The QCA's proposed approach will lead to anti-competitive practices which will operate to the disadvantage of potential new entrants and encourage capacity hoarding. The interests of current and potential access seekers demand a disincentive to over-contracting.

Dealing with network obstructions (clause 10.2(c))

The QCA notes that it is appropriate for Queensland Rail's rights to deal with obstructions be limited to anything it considers "reasonably" necessary, as this strikes a balance between the interests of the contracting parties. However, in dealing with network obstructions, Queensland Rail as network operator has broader obligations, including obligations to meet contractual requirements to other network participants, considering the interests of adjoining landholders and safety and environmental obligations.

Queensland Rail is concerned that this clause may be extended to mean that it could have rail safety, engineering, operational or other requirements watered down, disputed or replaced. Queensland Rail cannot be placed in a position where it incurs additional liability because third parties dictate safety, engineering, operational or other requirements relating to its rail network. Queensland Rail must be in a position to perform its statutory duties in a manner satisfactory to the Queensland Rail Board – the QCA cannot effectively delegate control of those functions to a counterparty to an access agreement.

Accordingly, the question of what is 'reasonable' is a broader question which must balance the interests of all access holders. There should be no change to this clause.

Termination of Agreement (clause 15.2(a))

Neither Pacific National nor the QCA provides any detailed rationale for this proposed amendment, which would fail to recognise any distinction in the role of Queensland Rail as network operator, with its obligations to other network participants. There should be no change to this clause.

4. Network Management Principles

Definitions (7.1 (definitions); sch. F)

The purpose of including a new definition for a class of 'ad hoc possessions' was to recognise the fact that the possessions included in the Master Train Plan (MTP) are possessions that are scheduled consistently at the same time during each year. AU1 definitions are:

"Planned Possession means a Possession (other than an Urgent Possession or an Emergency Possession) where such Possession is entered into the MTP or DTP and adversely affects the operation of Train Services;"

“Master Train Plan or MTP means a plan detailing the scheduled times as advised by Queensland Rail from time to time for all Train Services and any Planned Possessions on a specified part of the Network, where such scheduled times remain unchanged from week to week;”

Other possessions, while they are planned in advance, are not scheduled at the same regular intervals. Even so, Queensland Rail for practical purposes treats ad hoc planned possessions in the same way as changes to possessions contained in the MTP – in other words, it considers access holders entitled to the same rights to consultation and provision of contracted train service entitlements. The addition of the term “ad hoc planned possessions” was simply intended to expressly recognise these rights in the Network Management Principles.

Accordingly, Queensland Rail will adopt the QCA’s preferred terminology of “planned possessions” and “regularly planned possessions”.

Queensland Rail publishes an alignment calendar which includes all planned possessions. Queensland Rail will include in the NMP the requirement to publish and keep up to date the alignment calendar.

Modifications to Master Train Plan (sch. F, cl. 2.1(m)(ii))

Consistent with the discussion above, Queensland Rail will insert new sub-clauses in the NMP which mirror the consultation requirements for modifications to the MTP as a result of changes to ‘regularly planned possessions’.

Variations to Daily Train Plan to accommodate special events (sch. F, cl. 2.2(f)(i))

Special events are listed in the alignment calendar already published by Queensland Rail. Queensland Rail accepts the requirement to use reasonable endeavours to consult with Access Holders about changes to the DTP as a result of the scheduling of Special Events, and keep the alignment calendar up to date.

Traffic Decision Making Matrix (sch. F, cl. 3(g))

In theory, Queensland Rail has no objection to extending the on-time windows for freight traffic. Appropriate times may be 30 minutes for West Moreton System traffic and 60 minutes for North Coast Line System traffic due to the longer journey time. However, this may impact on network planning, requiring extra possessions or possessions of longer duration.

It should also be noted that Queensland Rail must comply with its passenger priority obligations under the *Transport Infrastructure Act 1994* (Qld).

Delays to MTP when under Dispute (sch. F, cl. 2.4)

In the QCA’s 2016 Final Decision on AU1 the QCA required that if a dispute was lodged by an access holder in relation to a planned possession Queensland Rail could not proceed with the planned possession until all disputes are resolved. In DAU2 Queensland Rail has removed this provision.¹⁷

In its explanatory document accompanying the lodgement of DAU2, Queensland Rail noted that no such provision is included in the ARTC access undertaking, and that Queensland Rail operates in similar regulatory circumstances to ARTC.¹⁸ That is, ARTC has similar incentives to Queensland Rail as neither compete in the above rail market, which has resulted in non-intrusive network management principles for ARTC.

Subsequent to the issue of the QCA’s DAU2 draft decision, the QCA approved the Aurizon Network UT5 access undertaking (February 2019), without this prescriptive requirement, even though Aurizon is an integrated organisation, with freight services competing in the above rail freight market. Queensland Rail seeks that the QCA reconsider its DAU2 Draft Decision in relation to this matter.

Queensland Rail must be able to run the network in an efficient manner and have discretion to make decisions relevant to the safe operation of the network. The QCA proposal will lead to inefficiencies and disruptions to the running of the network in some cases. It is also possible for stakeholders to use the process frivolously to compromise train running at the expense of or frustration to other parties.

This may not be possible if there is a major program of works being undertaken. This may also not be possible given train crew and train consist constraints from Rail Operators (for example, fatigue management requirements).

Queensland Rail acknowledges that the QCA proposes to address the concerns raised by Queensland Rail by requiring disputes to be lodged by access holders/operators at least 60 days before the planned possession. While not in agreement, if the QCA insists on maintaining the requirement that planned possession cannot proceed until disputes are resolved, Queensland Rail believes that, at a minimum, disputes should be lodged within two weeks of the MTP being locked down, which must take place three months prior to a Planned Possession, noting that detailed consultation takes place in the lead-up to the 3 month lock down of the MTP.

¹⁷ Queensland Rail’s Draft Access Undertaking 2 (DAU2) Explanatory Document 14 August 2018, p.64

¹⁸ Queensland Rail’s Draft Access Undertaking 2 (DAU2) Explanatory Document 14 August 2018, p.64

5. Reporting

Queensland Rail does not object to the QCA's DAU2 Draft Decision concept that the Below Rail Financial Statements and the Annual Performance Report be produced in one document. However, in practice the Below Rail Financial Statements have to be a separate document for external audit reasons, that is, the Queensland Audit Office will only audit the below rail financial statements as a stand alone document. While the documents will have to be produced and approved separately, for presentation Queensland Rail supports publishing the two reports in one document.

6. QCA Fee and Levy

Queensland Rail does not object to the proposal to simplify the process for addressing the QCA Fee and associated QCA Levy. However, the timeframes proposed by the QCA are not practicable.

The current process involves Queensland Rail receiving an annual estimate of the QCA Fee from the QCA in May/June for the coming financial year. However, Queensland Rail is not able to finalise the QCA Levy for the coming year until it receives the final audited and QCA Board approved fees for the financial year ending.

This is because Queensland Rail is required to compare the actual QCA Board approved fees versus QCA Levies collected through the access charges over the year and apply an adjustment for over or under recovery to the forecast QCA fees for the new financial year. For example, last year Queensland Rail did not receive the final audited costs from the QCA for 2017-18 until 11 September 2018. Therefore it is not possible for Queensland Rail to be able to publish the QCA Levy on its website within 30 days of it receiving the fee notice from the QCA, which for last year was on 19 June 2018.

Queensland Rail proposes to publish the QCA Levy on its website 30 days after it receives the final audited QCA Fee for the previous financial year. This would be more consistent with the current process and provide certainty.

7. Renewals

Queensland Rail agrees that renewal rights for new access seekers are more appropriately determined through negotiations between Queensland Rail and the access seeker and this approach is likely to deliver more efficient outcomes than a prescribed approach.

However, in relation to renewal rights for existing access holders the DAU2 Draft Decision says:

"While we consider that renewal rights are more appropriately determined through commercial negotiations between Queensland Rail and access seekers, access undertakings have explicitly provided renewal rights to Queensland Rail's mining customers for more than a decade.²¹⁸ Customers may have entered into contracts and made substantial sunk investments based on an expectation that renewal rights would continue to be specified in the undertaking. Removing renewal rights from the undertaking without transitional provisions for these existing customers may distort incentives to invest and adversely affect competition in dependent markets."¹⁹

Under QR Network's 2008 undertaking (**2008AU**) these renewal rights were only available to coal access agreements, and when registered in the committed capacity register. No West Moreton coal contracts were entered into the committed capacity register during the 2008AU term, which expired on 30 June 2015. Further, the QCA took the view that there was no access undertaking in place from the 2008AU expiry until AU1 was approved in October 2016. AU1 offered a one-off renewal right. As such, investments were not made on the basis of renewal rights as no such right existed until AU1.

Expanding the renewal rights for existing access holders may effectively lock out new entrants. In conjunction with the QCA's proposal not to prescribe relinquishment fees for non-reference tariff services, this will have anti-competitive effects, and encourage capacity hoarding.

However, Queensland Rail believes its original proposal to limit access to the renewal mechanism for existing coal and bulk mineral access holders with terms of between five and ten years is a reasonable compromise. Queensland Rail has experienced a trend over the last few years towards access agreement of shorter duration with many current access agreements now of one year term or less. The minimum five year term threshold for a renewal right was intended to remove the incentive for access holders to enter into short duration contracts, multiple times. If access holders were truly concerned about their potential sunk investment they would be motivated to contract longer term access agreements.

The maximum ten year duration threshold was intended to limit existing access seekers who have already had the benefit of a long term access agreement to recover their investment from receiving a renewal right.

It is reasonable that in the case of any longer term contract, at the time of renewal the original pricing intent will be unascertainable, or no longer applicable due to significantly changed circumstances. In those circumstances, Queensland Rail believes that it should be able to rebase pricing within the existing pricing principles of the Undertaking (i.e. floor, ceiling and price differentiation provisions).

¹⁹ DAU2Draft Decision p.89

Attachment 1: 87 Train Path 'Constraint' Letter



Queensland
Government

Office of the
Director-General

Department of
Transport and Main Roads

Our ref: DG36480

Your ref: 1353191

24 APR 2019

Mr Charles Millsteed
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Millsteed

Thank you for your letter of 22 February 2019 about the Department of Transport and Main Roads' (TMR) position on the '87 path constraint' on contracted access for coal trains through metropolitan Brisbane.

The metropolitan Brisbane rail network (the network) is shared between passenger and freight train operations, however, it has a primary purpose of supporting the operations of a public mass-transit passenger system. Under Section 266 of the *Transport Infrastructure Act (1994)* (TIA) the Chief Executive (Director-General of TMR) has responsibility to ensure proposed changes in passenger operations on the network are not disadvantaged by other train operations.

The typical 10-year duration of the West Moreton train path access agreements does not readily align with the Queensland Government's short and mid-term planning for continuous improvements to passenger train services on the network and this was particularly evident during the early part of this decade.

Prior to 2016, TMR's position was informed by the need to await outcomes of several passenger service planning reports having the potential to recommend increased frequency and duration of daily passenger operations on the network. The duration of the operations had the potential to reduce available time slots for non-passenger train operations.

During this period, TMR engaged with users and Queensland Rail to determine opportunities to add greater certainty to their investment planning necessary to underpin emerging increases in rail transport on the south-west and metropolitan Brisbane rail system. TMR was also cognisant throughout the period of the coal industry's opportunities to access additional ad hoc paths necessary to meet annual export targets.

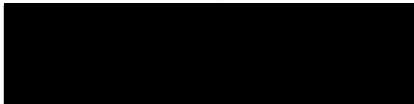
The insight gained from completed planning reports enabled TMR to determine that full utilisation of the 113 train paths available on the metropolitan Brisbane network, including those not preserved under TIA, did not present a challenge to passenger train operations. This outcome has since been used as a core traffic baseline in any new investigations involving passenger train services.

I am not aware of a specific date or visible marker of a change in TMR's position subsequent to 2015. However, I note in correspondence dated 23 December 2015, TMR formally recognised Queensland Rail's sole responsibility to determine the allocation of available train paths on the corridor while ensuring the continuing existence of 16 non-coal preserved freight train paths.

TMR advice provided to Mr Sam Fisher, General Manager Marketing and Logistics (New Acland Coal Pty Ltd/New Hope Group) in a 12 November 2018 letter reaffirmed this position advising there is presently no volume cap on coal exports and no deadline beyond which coal will not be allowed to be exported through the Port of Brisbane.

I trust this information is of assistance in your continuing works in relation to the Queensland Rail 2020 Draft Access Undertaking.

Yours sincerely



Neil Scales
Director-General
Department of Transport and Main Roads