QCOAL GROUP

Level 15
40 Creek Street
Brisbane Qld 4000

PO Box 10630
Adelaide Street
Brisbane Qld 4000

T +61 7 3002 2900
F +61 7 3002 2999

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Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Dr Roberts

Aurizon Network 2014 Draft Access Undertaking –Draft decision

QCoal Pty Ltd (QCoal) welcomes the opportunity to comment on the Queensland Competition Authority's (QCA) draft decision on Aurizon Network's 2014 Draft Access Undertaking (**Draft Decision**).

QCoal is one of a very small number of coal companies in Queensland that has both producing coal mines and coal mine projects at advanced stages of development which have or will commence production during the current UT4 access undertaking period.

While QCoal is an active member of both the Queensland Resource Council's UT4 Steering Committee and Working Group it would like to take this opportunity to add comment directly on the Draft Decision.

In this submission issues from the following sections of the Undertaking are raised for your consideration:

- Chapter 4: Ringfencing
- Chapters 15 & 16: Pricing Frameworks and Principles
- Chapter 17: Reference Tariffs

In addition we have some included general comments regarding Aurizon costs and the undertaking process.

Chapter 4 Ringfencing

QCoal has the view that despite all the structural and procedural mechanisms that can be imposed by an undertaking, ringfencing is most effective when it is engrained in the culture of staff and also when senior staff lead by example. Whilst QCoal supports the view that Aurizon should use the efficiencies created by operating as an integrated business, it must and should not use the access it has to information obtained from its monopoly business or exercise its monopoly power to generate advantages in other facets of its business.

All Aurizon staff, not only those of Aurizon Network, need to work in an environment where they are acutely aware of what information needs to be restricted and ringfenced. This cannot be achieved through process and mechanisms alone but also requires cultural change and awareness that must be constantly reinforced by Aurizon leadership.

The QCA has commented that "*there have been very few complaints and audit issues with respect to the existing ring fencing provisions*[1]. If by this statement the QCA means to imply that the lack of complaints means that there have been very few breaches of the UT3 ringfencing provisions we do not agree. QCoal would like to highlight that the lack of complaints is not surprising and it does not necessarily mean that there have been very few breaches. Unless a breach of ringfencing obligations is blatant, it is extremely difficult for an access seeker, access holder or another party that may interact with Aurizon Network, to firstly detect any breach and secondly to obtain evidence capable of proving either to the QCA or any other third party that a breach has occurred. Any breach would need to be substantial in its impact to warrant or justify a complaint being lodged.

As the QCA has also commented *"it is important that the (ringfencing) regime is not only effective, but is perceived by access seekers and access holders to be effective"*[2]. QCoal supports the QCA's position in the Draft Decision but it also considers it to be important that the costs of implementing, operating and monitoring that regime do not outweigh the benefits to be gained. The extent of any actual breach of the ringfencing obligations during the UT3 period and the impact of those breaches is unknown. QCoal would therefore request that the "value" of a ringfencing regime in terms of cost be considered as well as whether it has the potential to be effective as, ultimately, access holders bear the cost of these measures.

[1] Queensland Competition Authority Draft Decision "Aurizon 2014 Draft Access Undertaking – Draft Decision Volume 1 – Governance & Access" January 2015 page 49
[2] Ibid., page 45

Chapters 15 & 16 Pricing Framework and Principles

Expansion Pricing

Whilst QCoal generally supports many of the principles set out in Chapters 15 & 16 of the Draft Decision QCoal has significant concerns as to the current ability of Aurizon to accurately and effectively implement and manage these principles. In order for the expansion pricing principles to be fairly and equitably applied, as we consider is the QCA's intention, Aurizon must address cost allocation, recording and accounting issues. Before implementing the proposed expansion pricing principles, a number of critical areas of managing multiple tariff regimes within the one physical rail network must be resolved to ensure the principles espoused are realised. These areas include apportionment of sustaining capital, operations and maintenance costs, renewals and transfers.

QCoal also considers that a degree of socialisation between existing and expanding users should be applied:

- where existing access holders benefit from expansions,
- where the differential between existing and expansion users is small and,
- after due consideration of the costs and benefits of operating and managing two or more "systems" within the same physical track.

QCoal has serious concerns with the proposed imposition of UT4 expansion pricing principles to projects that were committed to and whose construction either commenced or was completed prior to the start of the UT4 regulatory period.

As the QCA reiterates throughout the Draft Decision, predictability and stability are important considerations and consider these one of the key principles in their assessment of the undertaking, for example it states:

"Predictability – the regulatory arrangements should be as stable and predictable as possible, given other objectives. Stability and predictability are likely to promote confidence in the regulatory arrangements and economic efficiency by reducing uncertainly associated with long – term investment decisions"[3]

QCoal suggests that the QCA's proposal to impose UT4 expansion pricing principles to access holders that made prior expansion commitments is inconsistent and indeed runs contrary to that principle.

[3]Queensland Competition Authority Draft Decision "Aurizon 2014 Draft Access Undertaking – Draft Decision Volume III – Pricing & Tariffs" January 2015, page 342.

Pricing arrangements are extremely important to access seekers who are miners. The cost of their commitment to a rail expansion is considered within the context of their broader mining investment decision and significant changes in those prices not only potentially jeopardise the broader mining investment/operation but also contributes to regulatory risk, creating further uncertainty, which is not conducive to further investment in mining in Queensland.

As the QCA relevantly writes:

"Do the pricing arrangements provide the right signals for investment in infrastructure?

(response).........*includes Aurizon Network being able to recover its efficient investment.......and access seekers and holders having predictability in the pricing and tariff arrangements, given the wider investment in mining and port infrastructure".* [4]*;*

and;

"We consider that providing an expansion pricing approach in the access undertaking will help to reduce uncertainty and enhance transparency with respect to access pricing. This is important for access holders and future access seekers considering expansion..."[5]

The QCA's proposed application of one element of the UT4 expansion regime, pricing, in isolation of the full expansion framework proposed in the Draft Decision, is not equitable. Unless the benefits in terms of the transparency and checks and balances provided to expansion access seekers under the Draft Decision's proposed expansion framework (such as the negotiation framework, capacity allocation and management, and expansion process) are applied, the costs, that is the expansion pricing principles, should not be applied.

Under the Draft Decisions' proposed UT4 expansion regime, the entire expansion process is much more structured and affords much more transparency and certainty to Aurizon, access seekers and the QCA. This degree of transparency and pricing certainty afforded future access seekers prior to them making significant financial commitments was not available at the time when previous expansions were undertaken. Examples of the mechanisms the QCA has proposed in its Draft Decision to be afforded future access seekers that will increase transparency and pricing certainty are:

"We consider a pricing proposal for an expansion would be better provided at the conclusion of the feasibility study when there is a significantly higher level of certainty about what costs and volumes would be. ....Accordingly .... the pricing proposal to be submitted to us (QCA) as part of the feasibility study report."[6]*,*

and,

[4] Ibid., Table 80 page 343
[5] Ibid., page 367
[6] Ibid. page 348.

(the) Purpose of a pricing proposal is to obtain pre-approval of the pricing methodology applicable to an expansion prior to entering constructing and funding arrangements. This enables potential investors to make an informed decision, and provides more certainty in relation to the pricing outcome."[7]

QCoal considers that it is fair and equitable that the expansion pricing principles (or framework) current at the time access seekers commit to expansion projects, are applied.

Chapter 17 Reference Tariffs

Newlands/ NAPE/ GAPE Tariffs

QCoal's own investigation into the development of the Draft Decision's GAPE, NAPE and Newlands system reference tariffs has highlighted a number of issues that it considers require further investigation and consideration by both the QCA and Aurizon Network, these issues include:

Newlands UT3 roll – forward

The QCA's figures[8] show substantial capital expenditure in FY12 & FY13 has been allocated to the Newlands system and this expenditure has predominantly been on upgrades to the system (ballast and culverts). QCoal queries whether this expenditure has been appropriately apportioned. As a result of the QCA's proposed pricing principles three "systems" (Newlands, GAPE and NAPE) are created, all using common infrastructure (the Newlands system) to access the port of Abbot Point (combined system). QCoal considers it logical that any sustaining capital expenditure upgrading the "Newlands" system be allocated between the all "systems" utilising the infrastructure, on a proportional basis and not be allocated in its entirety to the Newlands system, as appears to be the case proposed by Aurizon and the QCA.

The issue of this "combined system" traffic also raises questions as to how future allocations of sustaining capital, operations and maintenance are to be allocated, (see comments on Chapters 15 & 16). The concept of a "Newlands system" tariff is now blurred.

Allocation of excluded Newlands Capital indicator

QCoal queries whether the QCA's allocation of GAPE expansion capital expenditure is consistent with the allocation approach set out in its original GAPE pricing decision following its decision to exclude any share of expansion costs from the Newlands UT3 capital indicator.

[7] Ibid., page 363
[8] Queensland Competition Authority, Draft Decision, "Aurizon Network 2014 Draft Access Undertaking - Maximum Allowable Revenue", September 2014, Table 107

GAPE asset split

Aurizon Networks' allocation of common or indirect costs of the GAPE project between the various systems is not transparent and appears to be inconsistent with direct expenditure proportions.

QCoal strongly suggests that an independent assessment of the Newlands capital allocator and the project's allocation method between systems is undertaken prior to finalising the Newlands/ GAPE/ NAPE tariffs, and that clear principles for the allocation of costs between these three systems are established.

Basis of reference tariff

The importance and sensitivity of tariffs to volume forecasts has once again been highlighted during the development of reference tariffs. It appears that it is unlikely that there will be a consensus view on the appropriate forecast; each stakeholder is necessarily forecasting in a highly volatile environment where the likelihood of determining a consistent forecast is low.

QCoal therefore encourages the QCA to consider alternative methods to traffic forecasts in UT5 in order to determine tariffs and methods that enable smooth and consistent determination of reference tariffs.

Undertaking process

UT4 has highlighted a number of significant problems associated with the current undertaking process. The new undertaking is likely to commence more than two years into the four year regulatory period. This has created uncertainty to both industry and Aurizon.

The ability of Aurizon to control the format, content and timing of the submission of a Draft Undertaking will always place industry at a disadvantage. In addition industry is forced to pay for the services of Aurizon's extensive array of consultants. Industry must also fund its own consultants and advisors to consider and review the Aurizon-lodged undertaking, reports of its consultants and the QCA's decisions.

QCoal understands that as a result of a general dissatisfaction with the UT4 process, key stakeholders have already commenced preliminary discussions aimed at streamlining the process. QCoal supports a review of current processes with the aim of streamlining activities and delivering a more efficient and effective process, and encourages the QCA to also consider alternative approaches to the current process.

Aurizon Costs

As highlighted by the QCA in the Draft Decision (and Draft MAR Decision), a more transparent and evidence based cost proposal from Aurizon must be provided to enable both more accurate and timely decisions on tariffs, and that these decisions are ones in which all stakeholders have confidence.

Also, as a result of the Draft Decision's proposed expansion pricing methodology, which is likely to result in potentially a large differential between the tariffs of existing and expanding access holders, it is imperative that appropriate and accurate systems of recording and allocating costs is in place prior to any further expansions being progressed to an advanced stage. It is only with these measures in place that access seekers involved in those expansions are able to have clear cost information upon which to make their long term investment decisions. Unfortunately access seekers involved in past expansions have not had the security and protections afforded to future expansion access seekers under the Draft Decision.

The introduction of appropriate monitoring, incentives and penalties that encourage appropriate business behaviour in what is a private company operating in a monopolistic market is also supported.

Finally QCoal would like to recognise the time and effort the QCA has taken to deliver the Draft Decision and one that has introduced a number of new principles that, once fully developed, refined and appropriately implemented, will form the basis of a structure that will deliver an improved outcome for all stakeholders.

Yours sincerely

Deborah Silver
Manager Infrastructure