

Submission to Queensland Competition Authority

**Aurizon Network's Reply Submission on the
2013 Draft Access Undertaking (UT4)**

Anglo American Metallurgical Coal Pty Ltd

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Overview

Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes the opportunity to make submissions to the Queensland Competition Authority (**QCA**) in respect of the Aurizon Network Ltd (**Aurizon Network**) 2013 Draft Access Undertaking (**UT4**).

Anglo American generally supports the submissions of the Queensland Resources Council (**QRC**) and the suggested drafting proposed by the QRC, unless otherwise noted in Anglo American's October 2013 submission on UT4 (**Anglo American First Submission**) or this submission.

Since the Anglo American First Submission, Aurizon Network has since published its reply submission addressing a variety of industry's concerns in relation to UT4 (**Aurizon Network Reply Submission**). As many of these issues were dealt with in the Anglo American First Submission, in order to ensure completeness we have addressed each issue in full below, including UT4 generally, Aurizon Network's Reply Submission and the key issues still to be addressed, as submitted by Anglo American and industry generally.

We have set out this submission as follows:

- (a) **Section 1:** overview of Anglo American's submission in relation to the content of UT4 and Aurizon Network's submissions to date (we have addressed each part of the UT4 in order);
- (b) **Section 2:** overview of key issues that arise generally from Aurizon Network's proposed UT4 and submissions to date;
- (c) **Schedule 1:** Anglo American's proposed drafting of Part 6, Part 7 and Schedule H showing:
 - (i) QRC's amendments in red and blue; and
 - (ii) Anglo American amendments in green;
- (d) **Schedule 2:** Anglo American's proposed drafting of Part 8 showing:
 - (i) Anglo American's departure from the QRC's draft amendments in red; and
 - (ii) Anglo American's further proposed amendments in green including:
 - (A) Aurizon Networks suggestions that were not acceptable to Anglo American (in green strikethrough); and
 - (B) the suggested changes that were put forward by Aurizon Network in their proposed redraft which are acceptable to Anglo American; and
- (e) **Schedule 3:** Anglo American's explanatory notes on the Network Management Principles.

Unless otherwise defined, capitalised terms in this submission are to be given the meaning outlined in UT4 (or absent a definition in UT4, that outlined in UT3).

SECTION 1: Anglo American's response to UT4

1 Executive Summary

From the outset, Anglo American wishes to note that as the nature of Aurizon Network has changed, so too should some elements of the nature of the Access Undertaking regulating Aurizon Network's business. When UT3 was prepared and approved, QR Network was a government-owned body with only limited vertical integration. Since then, Aurizon Network's transition to a privately-owned enterprise, as well as the expansion of its vertically integrated interests (eg, port, as well as 'above' and 'below' rail) has changed its overall approach to the provision of rail access to the Queensland coal market. Importantly, government-entities have extremely different obligations and drivers to private entities.

This does not mean, contrary to Aurizon Network's numerous suggestions in UT4, that the Undertaking should further allow for Aurizon Network's business interests, or should provide less ringfencing, less oversight, or ultimately less regulation of the business.

Rather, Anglo American notes that as Aurizon Network's corporate focus shifts to profit-generation, including from non-regulated services, as part of a large corporate group, the drafting of the next Undertaking must, to ensure the effectiveness of the regulatory regime, reflect greater regulation, greater transparency and greater control to prevent the abuse of Aurizon Network's natural monopolistic position for the benefit of its related parties or its balance sheet.

Anglo American agrees with the comments made by Ro Tinto Coal Australia (**RTCA**) in its 10 October 2013 submission on UT4 (**RTCA First Submission**):

Economically, privatisation and increasing vertical integration has increased the ability and incentive for Aurizon Network to discriminate in favour of its related (unregulated) commercial activities, to engage in cost shifting and cross subsidisation and to seek to avoid scrutiny by customers and the regulator.¹

Further:

None of [Aurizon Network's] arguments justify the significant move towards deregulation of the CQCN which the draft UT4 represents.

Indeed, the opposite is true: the prospect of greater integration across its regulated and unregulated activities increases the ability and incentives for Aurizon Network to discriminate and engage in cost shifting / subsidisation.²

These comments are similar to the submissions made by Asciano in its October 2013 submission on UT4 (**Asciano First Submission**):

Thus the market positioning and approach of Aurizon Network is seeking to reduce regulatory impact and exploit its vertically integrated monopoly position, making the need for a strong non-discrimination regime significantly more important in [UT4] than it was in [UT3].³

As it is drafted, Anglo American does not believe that UT4 goes anywhere near achieving this goal.

In saying this, Anglo American notes that in the Aurizon Network Reply Submission, Aurizon Network has apparently accepted a number of points made by industry. While Anglo American appreciates Aurizon Network's positive response on these points, this submission does not

¹ RTCA First Submission, 5.

² RTCA First Submission, 28.

³ Asciano First Submission, 19.

contain detailed comments or any proposed drafting. Anglo American looks forward to Aurizon Network's next round of drafting and the implementation of these proposed amendments.

Anglo American makes the following submissions:

- (a) **Overall approach:** Anglo American does not support Aurizon Network's 'principles-based' approach to the drafting of UT4. Anglo American submits that the Undertaking should be transparent and unambiguous in order to counteract any risk of unfair advantage that may be subject to misuse inadvertently or otherwise, arising from Aurizon Network's clear natural monopoly and vertical integration;
- (b) **Outstanding issues:** Anglo American submits that the QCA should require Aurizon Network to address the numerous outstanding issues arising from UT3 before allowing a complete redraft of the Undertaking;
- (c) **Increased scope:** Anglo American does not support the extremely narrow scope that Aurizon Network has applied to 'Core Access-Related Services'. Anglo American submits that as a natural monopoly provider, all aspects of Aurizon Network's functions which are necessary to enable coal producers to obtain access to the CQC should be governed by a workable and transparent form of regulation. This is not reflected in Aurizon Network's drafting of the definition of 'Core Access Related-Services'. Anglo American's suggestions regarding the redefinition of the scope of the Undertaking are set out in section 3 of this submission;
- (d) **Ringfencing:** Anglo American fully supports the submissions and redrafting of Part 3 of UT4 proposed by the QRC in its October 2013 submission (**QRC First Submission**). While increasing its vertical integration, Aurizon Network has reduced its internal divisions some having been moved into other businesses within the corporate group, giving it greater scope and opportunity to advantage its related parties, even unknowingly. Anglo American submits that while Aurizon Network is now a privately controlled entity (requiring more extensive oversight), it is attempting to weaken its regulation and this should not be permitted. Anglo American's suggested amendments are outlined in section 4 of this submission;
- (e) **Negotiation framework:** Anglo American supports the views outlined in the QRC First Submission. Anglo American notes that the Aurizon Network Reply Submission does address a number of issues raised by industry, and a list of Aurizon Network's changes supported by Anglo American is included in section 5 of this submission;
- (f) **Access Agreements:** While Anglo American generally supports the QRC's comments (in the QRC First Submission) in relation to the access agreements, Anglo American is also concerned with the broadened scope of the access agreements. Importantly, Anglo American considers that the access agreements propose to give Aurizon Network powers similar to those of a central coal chain coordinator (but without the proper independence) and also contain numerous issues which should otherwise be contained in the Undertaking. This means that Aurizon Network is able to commercially negotiate the extent of its regulatory control, and essentially undermines the Undertaking entirely. A list of provisions previously appearing in UT3 which have since been moved to the access agreements appears at section 6 of this submission;
- (g) **Pricing principles:** Anglo American does not agree with the substantial amendments that Aurizon Network has made to the pricing principles from what was previously contained in UT3 (and expressed serious reservations with the UT3 pricing principles in its February 2010 submissions on the QCA Draft Decision on the 2009 Draft Access Undertaking). Anglo American does not support Aurizon Network's Part 6 of UT4, and whilst it generally supports the submissions made by the QRC in the QRC First

Submission, it has provided detailed submissions on this issue at section 7 of this submission, and has attached an extensive redraft of Schedule F of UT4 at Schedule 1 of this submission;

- (h) **Capacity allocation and management:** Again, Anglo American generally supports the redrafting and submissions in the QRC First Submission. Anglo American does not believe that the Aurizon Network Reply Submission adequately addressed any of industry's concerns. In particular, Anglo American is concerned that both the 'first in time' principle and the provisions governing formation of a queue for Capacity have been removed from UT4 to without clear rules as to the order of access applications (including the 'first in time' and 'queuing rules') Anglo American believes that there is a lack of certainty in UT4. Further, the Anglo American First Submission contained extensive submissions and redrafting concerning the Network Management Principles and System Rules, which Anglo American believes is essential to the proper operation of the CQCN: Aurizon Network has not adequately considered or incorporated this. As such, Anglo American has included further extensive comments (section 8) and redrafting (Schedule 1) of this submission;
- (i) **Expansion principles:** Anglo American does not support Aurizon Network's removal of the mandatory expansion regime. Anglo American fully supports the Productivity Commission finding (in relation to the National Access Regime) that regulators have the power to (and that it is entirely appropriate to) require mandatory expansions of a regulated entity, otherwise the regulator has no power to achieve the efficiency objective. Anglo American believes that the mandatory expansions regime should be reinserted in UT4, in addition to a more robust voting process, and has included submissions and redrafting in this submission (see section 9 and Schedule 1 respectively) outlining how this is possible;
- (j) **Connecting infrastructure:** Anglo American strongly supports the comments and drafting of the QRC First Submission in relation to this issue. Anglo American does not believe that the Aurizon Network Reply Submission adequately dealt with industry's concerns, and notes Aurizon Network's further attempt to reduce its overall liability (already close to zero) in this regard. Anglo American does not believe that Part 9 of UT4 should be approved without extensive redrafting;
- (k) **Reporting mechanisms:** As noted above, Anglo American is particularly concerned with the weakening of the ringfencing and compliance provisions in UT4. This is not assisted by Aurizon Network's attempt to reduce its overall transparency by reducing its reporting and audit requirements. Anglo American fully supports the drafting suggestions and submissions made in the QRC First Submission and does not believe that the Aurizon Network First Submission adequately addresses industry's main concerns;
- (l) **Dispute resolution:** Anglo American does not agree with Aurizon Network's plan to reduce the scope of the dispute resolution mechanisms in UT4 to only cover certain disputes, rather than applying to all matters relating to the Access Undertaking. Further, Anglo American submits that access agreements and the Standard User Funding Agreement (**SUFA**) should not be subject to their own internal dispute resolution mechanisms, but rather should be drafted so that they apply the provisions of Part 11. This will reduce confusion regarding the process, increase certainty for users and Access Holders and ensure that all disputes are resolved transparently and with the oversight of the QCA;
- (m) **The Regulatory Asset Base:** While Anglo American generally agrees with all comments made by the QRC in the QRC First Submission, it does not believe that only the net value

of disposed assets should be deducted from the RAB. Rather, the book value of any assets disposed (as recorded in the RAB) should be deducted so that in situations where Aurizon Network sells a regulated asset for less than the book value, users are not required to continue to pay for any residual value of an asset that no longer exists in RAB. Further, Aurizon Network should be held to account for what assets are appropriately in the RAB and whether any additional revenue streams are derived from those assets and what assets remain owned by other parts of the corporate group;

- (n) **Pricing for the Blackwater Electric System:** While Anglo American understands that Aurizon Network has withdrawn the 2013 Blackwater Electric Traction Pricing Draft Amending Access Undertaking (**2013 AT₅ DAAU**), it has not withdrawn schedule G of UT4 which replicates the same principles. As such, Anglo American has addressed the QCA draft decision on the 2013 AT₅ DAAU and its related concerns at section 14 of this submission. Anglo American does not support Aurizon Network's proposed socialisation of the AT₅ charge, and does not believe that diesel users should be forced to subsidise Aurizon Network's imprudent investment in electric traction. Further, Anglo American notes that the proposed socialisation incidentally benefits its related operator, Aurizon Operations, as it reduces the costs of electric traction (as Pacific National operates diesel trains on the Blackwater System); and
- (o) **Split Cost of Capital:** Anglo American reiterates its support for the QCA split cost of capital concept, as outlined in the QCA's April 2013 pricing paper *The Split Cost of Capital*. Anglo American believes that Aurizon Network is precisely the form of entity that would benefit from this concept, by reflecting the true risk on the CQCN and incentivising prudent investment at a second (generally higher) regulated WACC, provided that the base WACC is truly reflective of the risk, etc of the existing asset base. Anglo American encourages the QCA to continue its exploration of this concept for the pricing mechanisms in UT4.

2 Overall approach to UT4

2.1 Level of prescription required

Anglo American believes that the '*principles-based*' approach taken by Aurizon Network is unacceptable. UT4 has significantly reduced many of the regulatory protections for users that are currently contained in UT3. This is even more concerning now that the entire Aurizon Group of companies has been privatised as one entity.

A more principles-based approach to regulation may be appropriate where a natural monopoly provider of infrastructure is not vertically-integrated. Aurizon Network however, is vertically integrated and is proposing to extend its vertical integration under UT4 into interests in port terminals (ie the terminal at Abbot Point) and rail infrastructure other than the Central Queensland Coal Network (**CQCN**) (ie the Galilee Basin railway).

It may also be appropriate where a natural monopoly provider of infrastructure has clearly demonstrated that it is able to conduct negotiations of commercial arrangements based upon a reasonable commercial approach to risk allocation and fair to both itself and the users of the infrastructure. Anglo American believes that the conduct of Aurizon Network in almost all of its commercial negotiations places the interests of itself, its greater corporate group and its shareholders as the only relevant stakeholder. This is inconsistent with the regulatory regime which takes into account both the interests of the users as well as the legitimate business interests of the natural monopoly provider.

In deciding whether to approve UT4 one of the key considerations is the interests of the business owner / operator of the regulated asset. As identified in the QRC's submission of 10 October 2013

(QRC Submission), this is not defined in the *Queensland Competition Act 1997* (Qld) (**QCA Act**) and, therefore, should be interpreted in line with the objects of the Queensland access regime, namely the effect of promoting effective competition in upstream and downstream markets. This is supported by the QCA's previous determination in considered the initial access undertaking for the CQCN (ie, UT1) and the ACCC interpretation when considering the legitimate business interests of the ARTC under the Hunter Valley access undertaking.

In light of this Anglo American submits that the phrase '*legitimate business interests*' does not mean that Aurizon Network should be able:

- (a) obtain monopoly rent on any service provided relating to access to, and use of, the network including provision of access related services; or
- (b) to strike agreements which contain the risk allocation which is generally adopted by Aurizon Network (ie, that Aurizon Network will take no risk and users will take all the risk). Examples of this are complete tax and other indemnities, as are often required by Aurizon Network.

The purpose of a regulatory regime is to replicate, as far as possible, a competitive market. There is no competitive market in the world where the supplier/s in that market are able to obtain near zero risk in all major contracts.

In light of the behaviour of Aurizon Network under UT3 it is necessary that UT4 is prescriptive in its requirements and maintains the UT3 requirements as a minimum with adequate additional regulation to reflect Aurizon Network's new privatised agenda. In any circumstances where there has been any matter left open or unresolved (see section 2.5), such as a deferred outcome, under any of the previous undertakings Aurizon Network has exploited the gap to its benefit. Examples include:

- (a) in respect of the Goonyella to Abbot Point Expansion (**GAPE**) the negotiations and ultimate GAPE Deed were unacceptable because it is generally understood that this resulted in Aurizon Network obtaining a rate of return substantially in excess of the regulated WACC and including unacceptable access conditions (such as users being prohibited from raising disputes or making submissions to the QCA in certain circumstances). Anglo American's view of this negotiation was that Aurizon Network engaged in strategic investment hold-up behaviour to obtain unreasonable conditions as the length of delays placed pressure on the coal producers, particularly those who had invested heavily in the relevant mine projects, to concede to such unreasonable requirements;
- (b) in respect of the Wiggins Island Rail Project (**WIRP**) Anglo American believed that the agreements were unacceptable, but was hampered in making full submissions to the QCA in circumstances where it was entitled to under UT3 as a potentially '*affected party*' as Aurizon Network had claimed confidentiality over the agreements;
- (c) at the beginning of WIRP there was also a period where Aurizon Network and the users were negotiating terms of access but Aurizon Network denied that the discussions were '*negotiations*' as this would have obliged Aurizon Network to provide details of the access conditions and the additional risks being taken by Aurizon Network under UT3;
- (d) the negotiations on the SUFA involved almost 3 years of negotiations and still have not resulted in any agreement, in part because Aurizon Network would not accept general risk allocation principles (such as that the party that is best able to mitigate the risk) should carry the risk;

- (e) the negotiations on ancillary agreements, such as Transfer Facilities Licence (**TFL**) and Rail Relocation Deeds also involve inappropriate risk allocations and onerous conditions; and
- (f) attempts to socialise electrification costs under AT5 because the voting processes were inadequate under UT3.

In light of these, (as well as many other) examples, and the extent of Aurizon Network's vertical integration, Anglo American believes that UT4 must be prescriptive in nature in order to protect the users, as any other approach will be open to strategic gaming by Aurizon Network.

The QRC provided a good overview of the different regulation models and has rightly identified that in instances where a monopoly exists, it is critical that adequate regulation is imposed to ensure the monopoly provider does not abuse any flexibility (which is the usual practise for Aurizon Network to date). Accordingly, sufficiently detailed regulation is required to ensure the economically efficient operation of, and investment in, significant infrastructure, especially where users have formed a long term view toward investment and have contributed significant funds into the asset to date.

In the Aurizon Network Reply Submission, Aurizon Network submits that:⁴

In relation to the QCA's role, the UT4 proposal is entirely consistent with the UT3 position, namely, that the QCA has a fundamental role in approving standard access agreement terms, in approving Reference Tariffs and resolving access disputes.

This ignores that fact that whilst the QCA still has an oversight role in approving access agreements the removal of the details will lead to a significant number of disputes. As disputes usually related to the requests by the access seekers (eg, a request for access or a request for an expansion) any delay taken during an access dispute usually benefits the owner. This was evident in the telecommunications industry where there was originally a negotiated (or arbitrate) regime and ultimately the Parliament had to make the regime more prescriptive.

2.2 Increased power for Aurizon Network

Aurizon Network has sought to decrease the level of regulation in UT4 to allow itself greater power to optimise revenue and return of profit from its below and above rail operations. For example, Aurizon Network has removed regulatory oversight of access conditions, expansion and funding obligations, diluted the dispute resolution procedures and weakened the ringfencing mechanism (at a time where potential conflict between below rail and above rail operations are at an all-time high with further plans for port interests). Users are particularly vulnerable to this relaxation in regulation as:

- (a) users have less countervailing power in negotiations;
- (b) users have no alternative access to infrastructure; and
- (c) Aurizon Network may use ambiguity to effect lengthy hold-ups in negotiations and other tactics to assert power in negotiations.

Accordingly, users are reliant on a robust and efficient access regime to achieve a commercial outcome from negotiations with a monopoly service provider. As it is currently drafted, UT4 does not achieve, or go close to achieving, this outcome.

⁴ Aurizon Network Reply Submission (2013), p.11

2.3 Increased cost pressures

Further additional access charges affect users' ability to compete in the export market a time where cost pressures are compounded by historically low demand, high labour costs, a high Australian dollar, increased international competition and high volatility in international markets.

Anglo American does not agree with Aurizon Network's assertion in the Aurizon Network Reply Submission that the increased costs are modest and unlikely to affect the competitiveness of users. As it is not only the increase in tariffs that affect the competitiveness of users, but the general terms of access and length of negotiations in obtaining access to the CQCEN that affects users' ability to compete effectively in these volatile times.

Further, the consequent increasing revenues for Aurizon Network, whilst driving the cost base upward for producers in Queensland, has the effect of driving investment offshore where capital is scarce. Such higher charge, coupled with long term 'Take-or-Pay', has the effect of forcing producers to continue to supply oversupplied markets to reduce overall unit costs.

2.4 Outstanding issues from UT3

Anglo American notes that a number of issues are outstanding from prior to the approval of UT3. This has been identified by the QRC and various other stakeholders.⁵ Anglo American does not believe that Aurizon Network has made an adequate attempt to address these outstanding issues, nor that UT4 should be approved without the resolution of important elements of the regulation; especially since those resolutions were promised as part of UT3 and are now a number of years overdue.

In particular, Anglo American notes that:

- (a) no workable SUFA has been finalised, and Aurizon Network's approach to negotiating issues with industry has recently ended with it submitting a SUFA suite that does not reflect the discussions conducted;
- (b) while Aurizon Network has lodged a number of versions of System Rules, its approach to negotiating the provisions of those with industry has been similar to the approach seen with SUFA. Rather than submitting purely operational documents, Aurizon Network has submitted documents that also contain regulatory issues and it is uncertain whether those regulatory guidelines are supposed to fit with either the existing UT3 or a newly approved UT4;
- (c) an appropriate incentive mechanism to encourage Aurizon Network efficient and prudent investment in the CQCEN has not been finalised; and
- (d) a broad network condition assessment showing the capacity and extent of the existing CQCEN.

Anglo American does not believe that these issues should be left unresolved, and recommends that Aurizon Network properly address these in any redraft of the UT4 submission.

2.5 Conclusion

For the reasons identified above and in support of the detailed submission of the QRC, Anglo American submits that the level of prescription should be increased in line with that proposed by the QRC in its draft UT4 and including the submission otherwise identified in this submission. In particular a reduction in regulation as requested Aurizon Network is likely to result in significant disputes and delays and reduce the effectiveness of the regulatory regime.

⁵ See the Asciano First Submission, 15.

3 Part 2: Intent and Scope

3.1 Associated Services

The approach of Aurizon Network in seeking to limit the scope of UT4 to '*Core Access-related Functions*' is unacceptable. The definition of '*Core Access-related Functions*' is limited to:

- (a) negotiating Access Agreements and Train Operations Agreements;
- (b) procuring maintenance and renewal of Rail Infrastructure;
- (c) assessing, allocating and managing Capacity; and
- (d) scheduling and Train Control Services.

The QRC submits that UT4 should include a definition of '*Associated Services*' to extend UT4 to those associated services where the only practical service provider is Aurizon Network. Anglo American agrees with this approach.

The QRC suggests that the definition of '*Associated Services*' should include:

- (a) RIM and train control for spurlines;
- (b) level and other crossings;
- (c) land leases (leasing corridor land and land owned or leased by Aurizon Network); and
- (d) design, scope and standard reviews (for example, where Aurizon Network requires infrastructure to comply with minimum standards).

Further the QRC submits that pricing should be assessed by the QCA to reflect the actual cost plus a margin to reflect the risk borne by Aurizon Network in providing the service. Where there is a dispute over the terms it should be referred to an expert for determination. Anglo American supports these submissions.

Anglo American believes that in circumstances where there is a natural monopoly provider then all aspects of its functions which are necessary to enable coal producers to obtain access to the network to transport their coal must be the subject of a transparent and workable access regime, particularly where there is no commercial alternative service provider. Of course, any ancillary services which are contestable should not be subject to the access regime, but in assessing whether an ancillary service is contestable it must be truly contestable rather than weakly so, or at the margins.

For example Aurizon Network provides rail relocation and related construction services under proforma deeds, as an unregulated ancillary service. These deeds can become necessary in a range of circumstances, however, the relocation of rail and related infrastructure is not contestable at all. Similarly, TFLs (which deal with loadout interface requirements and other matters such as load profiling and dust veneering) are necessary where producers do not own the spur and loop being subject to Aurizon Network's requirements.

Anglo American believes that Associated Services must include those listed by the QRC in its submission and also, rail and related infrastructure relocation and TFLs.

In its reply submission Aurizon Network suggest that UT4 applies only to the negotiation and provision of access to the declared services, and is not applicable to the negotiation or provision of services other than access (other than clause 2.4 in relation to the supply of electric energy). Aurizon Network submits that the request is outside of the scope of the regulatory regime, however it intends to continue discussions with industry and remains willing to discuss a commercial model for the provision of these services.

Whilst Anglo American welcomes the opportunity to further negotiate this issue, it appears that this issue has been deferred to avoid an outcome. This goes to the very essence under which

Aurizon Network will deliver its services and given its previous conduct Anglo American is cautious that Aurizon Network will not reach an agreement with industry and the previous conduct in relation to these services (identified above) will continue.

Anglo American supports the submissions of the QRC and QRC's draft UT4 which should also include the additional activities identified by Anglo American above.

3.2 Electricity Supply

The QRC has provided a reasonable redraft of Part 2 of UT4 which includes, amongst other things:

- (a) a requirement for the supply of electricity to be on reasonable terms and conditions; and
- (b) a right for a party to refer the matter for expert determination in the event of a dispute.

Aurizon Network has not addressed these issues in its reply submission. Anglo American supports the QRC re-drafting.

4 Part 3: Ringfencing and Confidentiality

4.1 General comments

Anglo American agrees with the submissions of the QRC and its proposed mark-up of Part 3 of UT4.

It is absolutely essential that the ring-fencing requirements are strengthened in UT4. In Anglo American's view the requirements in UT3 have not been sufficient and there have been occasions where it believes that the ringfencing requirements may have been breached, however establishing that this is the case is almost impossible.

Aurizon Network acknowledges that where a declared service is provided by a vertically integrated business, a robust ringfencing regime is essential in providing third party Access Seekers and holders adequate confidence in the integrity of the regulatory framework.

It is understood that various functions from within Aurizon Network have been moved to Aurizon Operations such as the 'services' function which includes rail maintenance and project management and related construction services. In its reply Aurizon Network maintains that it is simply the services which are declared and not all the activities of the legal entity Aurizon Network Pty Ltd. Even if that were correct (which Anglo American submits that it is not) in order to ensure proper ringfencing for the asset, it is imperative that the operator of the asset does not share information with vertically integrated companies.

This is also vital for the competitiveness of the entire supply chain, including at other stages of the supply chain that do have competitive markets (eg, rail haulage). Asciano (as the other competitive rail haulage provider to Aurizon Network's vertically-integrated party Aurizon Network Operations) noted this point. Anglo American supports Asciano's comments that:

...without [a strong ringfencing and compliance] regime a vertically integrated natural monopoly will effectively act to disadvantage any existing third party access holder. Any actual or perceived dilution of the ringfencing and compliance regime will act to reduce both the confidence of any third party access holder that it is competing on a level playing field and the competitiveness of the third party access holder.⁶

Anglo American agrees with these comments and notes that while the ringfencing and compliance regime is vitally important for the control of Aurizon Network as a natural monopolist, it is also important to ensure the maintenance of competition elsewhere in the coal industry.

⁶ Asciano First Submission, 18.

Those competitive markets should not be detrimentally affected by the dilution of Aurizon Network's regulation.

Since the implementation of UT3, the Aurizon Group has expended considerable resources in evaluating and pursuing interests in Abbot Point Port and new rail infrastructure developments to support the Galilee Basin, with announcements to be made imminently. The Aurizon Group has publically advertised its intention to operate under a new integrated business structure and, given Aurizon Network's conduct to date, it is not unreasonable to assume that any ambiguity will be exploited to promote the overall leverage of the Aurizon Group. Further it is clear that members of the broader Aurizon Group have been involved in the drafting to support the above rail interests of the Aurizon Group.

4.2 Required amendments

In order to provide an adequate ringfencing regime the following, as a minimum, will need to be implemented:

- (a) a prohibition on secondments and contracts with Aurizon Network related entities, other than where it is approved by the QCA (which shall include a public consultation process);
- (b) a more balanced approach to the objective of Part 3, as per the QRC Submission;
- (c) clear separation between Aurizon Network's primary role of the provision of regulated access service (including the costing of such services) from their secondary commercial activities (such as port operations, above rail activities and rail operations outside the CQCEN) including, importantly, separate management teams;
- (d) an expansion of the general principles of non-discrimination, as per the QRC draft, including a separation of any activities in relation to Ports and rail services outside of the CQCEN;
- (e) expansion of the concept of Core Access-related Functions to include performance of all Below Rail Services (as defined in the QRC draft) and other activities identified in the definition of Access-related Functions in the QRC draft.
- (f) inclusion of Aurizon Network's Conflict Protections in UT4 to ensure regulatory certainty for users;
- (g) the reinstatement of provisions in UT3 in relation to rail transport infrastructure to ensure that:
 - (i) Aurizon Network remains responsible for all rail transport infrastructure including those listed by the QRC in its submission and also, rail and related infrastructure relocation and TFLs;
 - (ii) there is a clear prohibition on the transfer of such ownership to a related party without QCA approval;
 - (iii) there is a clear avenue for users to challenge the allocation of rail transport infrastructure where they reasonably believe Aurizon Network does not have sole responsibility for rail transport infrastructure that forms part of the declared service (and to be able to refer the matter to the dispute regime where required); and
 - (iv) that the required infrastructure is categorised as 'red track' and that this is overseen by the QCA and may be moved as required where incorrectly categorised as 'blue track';

- (h) proper incentive for Aurizon Network's ultimate holding company to comply with the requirements of the support deed and avenues for parties to lodge a complaint where the ultimate holding company does not do so;
- (i) a new confidential information regime, which provides additional governance of confidential information and captures all information as part of the regulated business and not just '*commercially sensitive information*', as set out in the Aurizon Network submission;
- (j) a more comprehensive complaints handling process, as per the QRC draft;
- (k) more meaningful consequences where Aurizon Network breach their obligations under the ringfencing regime; and
- (l) the ability for the QCA to conduct an annual compliance audit for Aurizon Network's ringfencing obligations and audit the Protected Information Register.

Anglo American further supports the management requirements suggested in the Asciano First Submission, including:⁷

- (a) an independent Board;
- (b) an independent executive management team;
- (c) strong limitations on staff exchange; and
- (d) strong informational control, with minimal information transfer between the regulated entity and organisation as a whole.

In its reply submission Aurizon Network has identified limited instances where it is willing to include additional ring-fencing requirements. Whilst Anglo American supports the proposed amendments by Aurizon Network, the additional requirements identified above are essential to ensure that the ringfencing regime is adequately robust to isolate Aurizon Network's below rail activities from the other activities of Aurizon Network and its related parties. Further the QRC have put forward a proposed draft that is prepared on reasonable terms which Aurizon Network has failed to address directly.

Anglo American also supports the retention of the Confidentiality Agreement between Aurizon Network and an Access Seeker, a pro-forma of which appeared in Schedule B1 of UT3 in the terms suggested by the QRC. Anglo American believes that the QRC draft should also include liquidated damages provisions in the same terms as clauses 4 and 5 of the Confidentiality Agreement at Schedule B1 of UT3 (including clause 4.2 which specifically provided that any dispute in respect of the clause may be referred to the QCA). Aurizon Network has agreed to include an obligation to publish a standard from Confidentiality Deed as part of the preliminary information. Anglo American submits that Aurizon Network ensure that the proposed Confidentiality Deed meets the specification identified above.

Anglo American submits that the form of ringfencing regime drafted by the QRC be adopted in its entirety and also include the issues identified in Anglo American's submissions above.

4.3 Ultimate Holding Company Deed

Aurizon Holdings Ltd must execute the Ultimate Holding Company Deed to ensure that it and all other related parties of Aurizon Network support the Conflict Protections. Anglo American supports the view of the QRC that deed proposed by Aurizon Network in UT4 does not adequately address the following issues:

⁷ Asciano First Submission, 27.

- (a) compliance is limited to ensuring no contrary direction or request are issued by the ultimate holding company however there is no requirement to provide positive assistance as is required under UT3;
- (b) Additional provisions are required to ensure compliance by the broader corporate group for treating confidential information; and
- (c) The deed should specify a separation of management between the regulated entity and related entities including especially the ultimate holding company.

In addition to these concerns, Anglo American submits that there should be much more detailed requirements for the ultimate holding company to guarantee the obligations its subsidiary. Further the deed as prepared does not comprehensively address the issues identified in Part 3.3 of UT4 and should be provided in sufficient detail to allow adequate submission to be made by industry.

In its reply submission, Aurizon Network dismiss these issues stating simply that the '*deed reflects Aurizon Holdings' commitment to a robust access regime*'. Anglo American submits that Aurizon Network have failed to provide a deed that adequately addresses the required issues set out in UT4 and industries response and has simply dismissed concerns raised by industry offering no substantive response. This is of particular concern to Anglo American, given the recent privatisation and shifted commercial focus and supports the view that Aurizon Network's vertically integrated entities have assisted in the preparation of UT4.

Anglo American supports the proposed amendments to the Ultimate Holding Company Deed proposed by the QRC and submits that the additional comments above should also be addressed.

5 Part 4: Negotiation Framework

Anglo American supports the views of the QRC in its submission, namely:

- (a) the inclusion of a mandatory requirement for Aurizon Network to notify an Access Seeker that their Access Application is incomplete;
- (b) the inclusion of the following acknowledgements:
 - (i) the expiry date of an Indicative Access Proposal does not apply where access is contingent on an Expansion or customer specific branch line; and
 - (ii) that a rail haulage operator may only apply for access, or hold Access Rights, on behalf of a specified Customer;
- (c) the broadening of the requirement for a train operator to identify the relevant End User or Customer, including evidence of their appointment;
- (d) the reinstatement of the UT3 mechanism for proceeding with negotiations where Aurizon Network becomes unable to offer access because of a reduction in available capacity or infrastructure enhancements, including where required, a revised Indicative Access Proposal, at the request of the Access Seeker, where the remaining available capacity could satisfy part of the Access Rights sought, or the infrastructure enhancements could be altered to allow for the provision of the Access Rights (clause 4.9.1(c)(v));
- (e) the removal of the ability for Aurizon Network to separately levy costs associated with an Access Application over and above what is already provided for in operating costs (clause 4.9.2(f));
- (f) the removal of the right to include details of '*other terms and conditions comprising of the access agreement*' during the negotiation process and replace it with a clause that provides that, '*unless otherwise agreed, the terms and conditions comprising the access agreement are to be those in the standard access agreement*' (clause 4.9.2(a)(viii)); and

- (g) the requirement for various tests under Part 4 to be objective tests as opposed to a subjective test based on Aurizon Network's opinion (i.e assessment for cessation of an access negotiation (clause 4.11(a)).

Further Anglo American is supportive of Aurizon Network's proposal to some of the industry's suggested amendments, and Anglo American look forward to seeing these proposals properly reflected in the next round of Aurizon Network drafting. In particular Anglo American supports:

- (a) the proposal by Aurizon Network to set out limitations to the information that may be requested in relation to an Access Application (clause 4.3(c)) and the ability to utilise an Access Application (clause 4.9.2(d));
- (b) the proposal for Aurizon Network to provide reasons where negotiations are suspended and a right for industry to suspend negotiation where expansions or a customer specific branch line is required (clause 4.4(c));
- (c) the inclusion of a restriction on discriminating between a user funding project and an Expansion to be funded by Aurizon Network (clause 4.4(c));
- (d) the inclusion of an extension for application for access up to 5 years (clause 4.4(e)) but with renewal rights or an ability to align the term of any rail access agreement with 'exit capability' without losing renewal rights to enable alignment of rail and port commitments;
- (e) the proposal that an Access Seeker should only need to demonstrate a reasonable likelihood of being able to utilise the Access Rights by the time the Access Rights are to commence (clause 4.4(f)(iii));
- (f) the inclusion of a requirement for Aurizon Network to act reasonably when issuing a Negotiation Cessation Notice (clause 4.4(g));
- (g) the right for an Access Seeker to vary or revise its Access Application (other than in relation to an increase in capacity, a shorter term of access, or a change which substantially alters the nature of the Access Rights) (clause 4.5);
- (h) the reinstatement of the requirement to set out details of the initial access charge and expansion planning in an Indicative Access Proposal (clause 4.5(b));
- (i) the alignment of the timeframe for notification of an extension with that outlined in UT3 (clause 4.5.(d));
- (j) the strengthening of the obligation to review a revised Indicative Access Proposals to ensure alignment with the Undertaking (clause 4.5(g));
- (k) the ability to nominate an operator to negotiate access on behalf of an End User (clauses 4.7(a)(i) and 4.10(a)(ii));
- (l) the extension to the negotiations to allow for disputes (clause 4.9.1(c)(iv)(B));
- (m) the increased clarity regarding non-standard operations (clause 4.9.2(c)); and
- (n) the proposal to allow an Access Seeker to amend their Access Application during the negotiation period in reasonable circumstances (clause 4.9.2.(e)).

As there is substantial proposed amendments to this section, Anglo American supports the current QRC drafting of this Part 4, including its suggested amendments above. Anglo American will provide suggested drafting (if required) following further amendments by Aurizon Network.

6 Part 5: Access Agreements

6.1 General issues

Anglo American has several concerns with new access framework under UT4 including the proposed Standard Access Agreement (**SAA**). Anglo American generally supports the proposed amendments to the SAA in the QRC First Submission. In addition, Anglo American submits the following issues for the QCA's consideration:

- (a) the SAA proposes to give powers to Aurizon Network similar to those of a central coal chain coordinator;
- (b) the SAA has introduced several concepts that create greater negotiation powers in favour of Aurizon Network when negotiating access with Access Seekers;
- (c) the new framework seeks to remove many of the rights in relation to access from the undertaking itself and move them to the SAA;
- (d) the SAA seeks to reduce Access Holders' security over their rights, including increased relinquishment and resumption powers for Aurizon Network;
- (e) the introduction of the concept of 'Train Service Type' allows Aurizon Network greater scope for pricing differentiation between different users; and
- (f) the access regime would benefit from a short term capacity transfer process to facilitate the development by industry of more effective and flexible coal chain coordination and efficiency arrangements.

6.2 Central coordination of the coal supply chain

Aurizon Network has introduced a broad 'supply chain' trigger for Aurizon Network to withdraw rights under the SAA.

Anglo American believes that centralised coal chain coordination is key to ensuring scheduling so that, first, the greatest number of contractual entitlements are delivered and that, second, the overall throughput of the various systems (including related assets) is able to be maximised.

However, this role should not be undertaken by Aurizon Network as it is part of a vertically integrated business with significant growth plans and, as such, the role is best performed by a completely independent party. This independent system has been successfully employed in other regulated coal chain environments, eg, Hunter Valley Coal Chain Coordinator. Anglo American recognises that this objective may not be able to be achieved by the QCA under UT4, but believes that the QCA should consider the issue and raise the necessary reforms with Government.

Anglo American submits that the proposed amendments identified by Aurizon Network above be removed.

6.3 Additional negotiating power for Aurizon Network

The proposed SAA is not evenly balanced and does not provide a commercially feasible negotiating framework or competitive neutrality. For example:

- (a) a reduction in the nominated monthly train services may only be triggered by Aurizon Network, and not the Access Holder / End User;
- (b) End Users are unable to dispute a range of important operational and commercial issues such as changes to train payloads;
- (c) Aurizon Network has been provided with a greater discretion to cancel Train Services;

- (d) there is an increased requirement for an Access Holder to provide Aurizon Network with information to support its relinquishment of capacity; and
- (e) one sided rights in favour of Aurizon Network in relation to set off, indemnity and consent provisions.

Anglo American submits that the balance of power is addressed to ensure equal bargaining power between Aurizon Network and industry, the purpose that is intended by regulation.

6.4 Issues moved from the Access Undertaking to the Access Agreement

Aurizon Network's UT4 removes a significant number of important regulatory elements from the Access Undertaking and places them in the SAA. This is concerning due to the resultant lack of regulatory oversight.

The following provisions have been removed from UT4 and placed in the Access Agreements:

- (a) Resumption: currently clause 7.3.5 of UT3, not included in UT4 but dealt with in clauses 8 and 15 of Aurizon Network's UT4 Access Agreement;
- (b) Reduction of Access Rights: currently clause 11.3(c)(v)(C)(2) of UT3, not included in UT4 but dealt with in clause 9.3 of Aurizon Network's UT4 Access Agreement;
- (c) Relinquishment: currently clause 7.3.6(d) of UT3, not included in UT4 but dealt with in clause 12.4 of Aurizon Network's UT4 Access Agreement;
- (d) Transfers: currently clause 7.3.6(d) of UT3, not included in UT4 but dealt with in clause 13.5 of Aurizon Network's UT4 Access Agreement;
- (e) Reduction factor: currently clause 7.3.6(n) of UT3, not included in UT4 but dealt with in clause 14 of Aurizon Network's UT4 Access Agreement;
- (f) Compliance: various references throughout UT3, not included in UT4 but dealt with in clause 17 of Aurizon Network's UT4 Access Agreement forming;
- (g) Train operations: currently clause 5 of schedule E of UT3, not included in UT4 but dealt with in clause 19 of Aurizon Network's UT4 Access Agreement;
- (h) Rollingstock interface standards: various references throughout UT3, not included in UT4 but dealt with in clause 20 of Aurizon Network's UT4 Access Agreement;
- (i) Management of network: clause 6 of schedule E of UT3, not included in UT4 but dealt with in clause 24 of Aurizon Network's UT4 Access Agreement; and
- (j) Interface and environmental risk management: currently considered under Part 8 of UT3, not included in UT4 but dealt with in clause 28 of Aurizon Network's UT4 Access Agreement.

Aurizon Network has suggested that this process has been undertaken in order to attempt to streamline the Access Undertaking by removing complex and cumbersome aspects of the regulation.⁸ In particular, Aurizon Network notes that this is because of its drive to incorporate the commercial interests of its shareholders and removes some of the aspects linked directly to public ownership and old objectives of the Aurizon Group.

Anglo American does not support this approach, as many important aspects of regulation which are necessary to ensure access on appropriate terms have been removed from the Undertaking itself. This means that any issue now only contained in the SAA is open to be the subject of commercial negotiations. While Anglo American ordinarily prefers commercially negotiated

⁸ Aurizon Network, *UT4 Submission: Volume 2* (2013) p25.

outcomes, based on previous negotiations with Aurizon Network it is not confident that such important issues should be left to the Access Agreements. In the absence of an alternative transparent regulated process, Aurizon Network is able to exercise its monopolistic power unchecked, as has been the case in the examples previously cited. Conversely, there is no good reason why such aspects should not remain the subject of regulation, providing a 'backstop' should commercial discussions not be fruitful. In fact, these aspects are common to all users and therefore should remain in the relevant access undertaking given they relate to the provision of access generally and not simply contracting of train paths.

Under the QCA Act the QCA is required to approve an undertaking and any amendments to an undertaking must be made in the form of a draft amended undertaking. However, an access agreement may be negotiated between the parties on commercial terms, and therefore does not provide the same level of certainty for the terms as terms in the undertaking, as these can be negotiated out of or changed at any time.

In particular, Anglo American is deeply concerned that the dispute resolution clauses in the Access Agreements do not allow a party to unilaterally refer a dispute to the QCA. Therefore, unless Aurizon Network agrees to allow a matter to be referred to the QCA; the approach adopted by Aurizon Network under UT4 will essentially remove the ability of coal producers to raise non-compliance with the QCA. The QCA will be unable to monitor, investigate or intervene in any non-compliance with the Access Agreement. Conversely, whereas under UT3 the QCA has jurisdiction to deal with, by way of example, a non-compliance in respect of the transfer of Access Rights. As industry and Aurizon Network have rarely been able to resolve difficulties by satisfactory mutual agreement, Anglo American has no confidence that the approach to dispute resolution in the Access Agreements is appropriate on such critical issues as outlined below.

The CQCN was regulated because of its vital position as part of the Queensland coal supply chain and the fact that it is a clear natural monopoly existing as one element of that supply chain (noting its parent has related interests in other elements). As the Aurizon Group continues to expand its interests through other vertically integrated elements of the supply chain, more aspects of the Aurizon Network business should be incorporated in, and subject to, the scope of the Access Undertaking, rather than the other way around.

In the Aurizon Network Reply Submission, Aurizon Network states:⁹

...the entire 2013 DAU (Volumes 1, 2 and 3) is collectively "the undertaking" for the purpose of the Act, with the agreements subject to the same statutory tests and scrutiny for their approval as the undertaking itself...

The fact that certain provisions, such as resumption (for example), are not contained in the undertaking but rather is agreed as a matter of contract, does not in any way alter Aurizon Network's obligations under Part 3 of the 2013 DAU. Removing these provisions from the undertaking provides no protection to Aurizon Network if it unfairly discriminates against a third party in agreeing and/or applying the resumption provisions.

It is also important to emphasise that the QCA has extensive powers to scrutinise Aurizon Network's conduct under agreements. Clause 10.3.1 in the 2013 DAU still requires Aurizon Network to disclose the below rail aspects of access agreements to the QCA "to allow the QCA to satisfy itself that the Below Rail aspects of the Access Agreement do not offend against the provisions of this Undertaking or the Act." An equivalent power to scrutinise access agreements with a related party is in the Act.

Aurizon Network's reply makes a few key omissions, specifically:

⁹ Aurizon Network reply submission, November 2013 p17-18

- (a) whilst all of the documents may be subject to initial scrutiny for their '*approval*', the Access Agreements will not be subject to the same level of '*ongoing*' scrutiny by the QCA as the Access Undertaking;
- (b) whilst these provisions are governed by the restrictions on unfair discrimination, they are not governed by the usual scrutiny of the QCA that would apply if they were part of the Access Undertaking (ie, subject to the disputes regime);
- (c) whilst the QCA can still use its powers to scrutinise the Access Agreements, it has removed the ability for a user to exercise its rights as it would if these terms formed part of the Undertaking (ie, dispute resolution); and
- (d) stakeholders should have the right to make meaningful submissions to the regulator on aspects common to or affecting all users of the Network either directly or indirectly.

Should Aurizon Network wish to implement change then it can do so under DAAU in a transparent way rather than using monopolistic power behind closed doors dealing with users on individual basis.

This is a deliberate attempt by Aurizon Network to reduce the constraints of regulation and to gloss over the issue in the Aurizon Network Reply Submission by making material omissions.

In response to industry pressure, Aurizon Network has agreed to consider areas where the proposed movement of provisions from the Undertaking to the Access Agreement could cause a genuine problem; for example, Aurizon Network is intending to clarify the drafting of the dispute resolution provisions in Part 11 to state that these provisions apply if a dispute is raised in any access negotiation, whether or not the provisions subject to a dispute are set out in the Undertaking or in an (unexecuted) Standard Access Agreement (although Anglo American considers this issue further below).

Anglo American welcomes the considerations of Aurizon Network but insists that the QCA ensures that these fundamental elements of natural monopoly regulation are reinserted into UT4 in order to ensure transparency and certainty for industry, as well as the essential element of QCA oversight.

6.5 Introduction of 'Train Service Types'

Aurizon Network has sought to expand the scope of its discretion by introducing the concept of '*Train Service Types*' allowing Aurizon Network's to apply different terms and pricing of access between Access Holders.

Anglo American submits that the application of this concept will almost certainly lead to discrimination between the pricing and risk sharing between users. Accordingly, Anglo American supports the removal of this concept from the SAA.

6.6 Short Term Transfer mechanism

RTCA has proposed that a short term transfer mechanism be introduced. In the RTCA First Submission, RTCA stated that:¹⁰

The need for Aurizon Network to modify system rights would also not be as relevant if access holders had a workable short term transfer framework which they could use to manage their own contractual alignment – as occurs today in the Hunter Valley.

Anglo American supports the proposal that a short term capacity transfer process would allow industry to facilitate effective and flexible coal chain coordination and efficiency arrangements.

¹⁰ RTCA First Submission, 105.

7 Part 6: Pricing Principles

Aurizon Network has made substantial changes to the pricing principles when compared to those outlined in UT3. Anglo American addresses each of the key issues below. Anglo American has also attached a proposed mark-up of Part 6 at Schedule 1. This is marked-up against the already modified QRC version to assist with the QCA's consideration of the required amendments. The mark-up which appears in green is the mark-up suggested by Anglo American.

7.1 Pricing objectives

Anglo American supports the view of the QRC that pricing objectives should be set out in the Undertaking. Anglo American agrees that it is not possible to canvass every different pricing scenario and notes that in many instances Aurizon Network has a high level of flexibility to determine the applicable Reference Tariff and Access Charge and therefore implementing pricing objectives will ensure that any decision made by Aurizon Network is made in accordance with the spirit of the objectives of the parties.

In the Anglo American Submission (at item 61 of Annexure A), Aurizon Network dismisses the requirement for clear objectives and states its intention to work with industry to determine each issue on a case-by-case basis. This is a key example of Aurizon Network seeking to free itself from regulatory oversight and to have commercial negotiations outside the framework of the Undertaking, which would provide unfair bargaining power to Aurizon Network.

Anglo American submits, however, that the pricing objectives should not be limited to the determination or amendment of Reference Tariffs, but also to setting the Access Charges. This will ensure that Aurizon Network's discretion is applied in accordance with the spirit in which the provision is intended and to promote efficiency and fairness for users.

Anglo American has its attached our proposed mark-ups in clause 6.2 of Part 6 at Schedule 1.

7.2 Price differentiation

There have been significant omissions to the restrictions on price differentiation in Aurizon Network's proposed UT4, in particular:

- (a) the ability of an aggrieved Access Holder to apply to have its Access Charge amended (clause 6.1.3 UT3); and
- (b) establishing restrictions on Access Charges for Related Operators preventing or hindering access by a third party into any market in competition with that Related Operator (clause 6.1.3 UT3).

There are no valid reasons why these requirements would be removed and Anglo American submits that they be included in UT4. In the Anglo American Submission, Aurizon Network state that the rights of aggrieved Access Holders to change their Access Charges should be set out in the Access Agreement which is negotiated with Aurizon Network. As previously identified this is exactly the monopolistic negotiation framework which the Access Undertaking seeks to avoid.

The ability for an aggrieved party to rectify an inaccurate Access Charge is paramount to ensure fairness across all users. Anglo American have set out its concern with moving items to the Access Agreements above at paragraph 6.4 of this submission.

In relation to Aurizon Network's obligations to Related Operators, Anglo American agrees with Aurizon Network's submission that this obligation is consistent with its obligations under the QCA Act and, accordingly, Anglo American sees no reason why this should be removed from UT4. Including this requirement in the Undertaking will also allow easy access to dispute resolution between the parties. Accordingly Anglo American submits that these provisions be included in UT4 and has marked-up clauses 6.3.4 and 6.3.5 of Part 6 (see Schedule 1 of this submission).

Further, Anglo American notes that the Capacity Multipliers have been substantially increased to 1.59 and 1.63 for the Blackwater and Goonyella lines respectively from 2015. Aurizon Network has provided no reasoning for such substantial increase. Anglo American does not consider that this increase is reasonable and submits that it be revised including evidence for any increase.

7.3 Pricing limits

Aurizon Network has included a new provision allowing for a breach of the pricing limits regime provided that they comply with the price differentiation regime in setting an Access Charge for a subsequent Access Seeker. This provision does not make sense and Anglo American does not understand why Aurizon Network should be granted a right to avoid compliance with the pricing limits on the basis that it complies with the pricing differentiation regime for a different Access Seeker. This provision should be deleted (see clause 6.4.2(b) of the amended Part 6 attached at Schedule 1 of this Schedule).

7.4 QCA oversight of changes to Reference Tariffs

Aurizon Network has removed many of the provisions governing the implementation of Reference Tariffs, including removing QCA oversight over terms of the Reference Tariff. Given Aurizon Network's privatised agenda, and the proposed reduced scope of the restrictions surrounding issuing Reference Tariffs and QCA regulatory oversight generally, it is essential that the issue of Reference Tariffs is adequately supervised to a standard not less than that set out in UT3.

Anglo American supports the QRC's views generally in relation to the process for calculating Reference Tariffs and the level of QCA oversight required. In particular, Anglo American agrees that QCA approval must be required for any amendment to, or implementation of, a Reference Tariff which shall include a public consultation process (as set out QRC's amendments to clause 6.3.8 of Part 6 at Schedule 1).

In the Aurizon Network Reply Submission, it submits that QCA approval may not be required where the Reference Tariff is averaging down and therefore Aurizon Network should have the discretion as to whether to apply to the QCA for approval. It is clear that the current use of the word 'may' has the effect of removing any obligation on Aurizon Network to refer the issue for QCA oversight and, therefore, Aurizon Network's response is inaccurate. Anglo American would prefer a clear requirement for Aurizon Network to seek QCA approval and to provide a specific carve-out where industry has agreed that QCA approval is not required. Anglo American is not aware whether such carve-out has been agreed and, therefore, has not provided any suggested drafting.

Anglo American also supports the QRC's view that the existing reference tariff should be the highest reference tariff for an equivalent train service (see QRC's amendments to clause 6.3.7 of Part 6 at Schedule 1).

Further, Anglo American notes that on the current drafting of UT4, Aurizon Network has great flexibility to determine the extent to which the Access Charge should depart from the Reference Tariff, or in the absence of the Reference Tariff, to those Access Charges of similar users. Accordingly, to ensure that any deviation is merited Anglo American submits that where Aurizon Network proposes that the Access Charge should depart from the Reference Tariff or (in the absence of the Reference Tariff, to those Access Charges of similar users), it should also be subject to QCA oversight. We have marked-up our suggested amendments to paragraph 6.3.8 of Part 6 at Schedule 1.

Finally we note Aurizon Network has removed the following rights of the QCA that existed under UT3:

- (a) the QCA's ability to provide a notice requiring Aurizon Network to submit a Reference Tariff (as per paragraph 6.4.2(c) of UT3); and
- (b) the QCA's ability to develop a proposed Reference Tariff consistent with the Undertaking where Aurizon Network do not comply with the notice issued by the QCA (as per paragraph 6.4.2(e) of UT3).

Anglo American submit that the QCA should retain these powers as the QCA requires the ability to step in where Aurizon Network blatantly do not wish to comply with their own Undertaking on repeat occasions. Anglo American have amended clauses 6.3.8(f)(ii) and (h) in Part 6 of Schedule 1 accordingly.

7.5 Rail Infrastructure Utilisation

Aurizon Network has removed the requirement to reduce Transport Service Payments where they earn a revenue in excess of the adequate revenue. It is not clear why this has been removed. Where these payments are no longer required to be made to Aurizon Network then this removal is satisfactory. However if these payments are still payable, then Anglo American submit that this requirement should be reinstated as Aurizon Network operate under a revenue cap and bear no risk and therefore should use any additional return to lower the cost for users. We have amended clause 6.5.2 of Part 6 at Schedule 1 accordingly.

7.6 Commercial Terms

Paragraph 6.9 of Aurizon Network's proposed UT4 sets out the terms on which parties may separately negotiate commercial terms for access. Anglo American supports QRC's suggestion that this should exclude any commitment whereby Aurizon Network is obliged to fund any expansion or any related studies or where it involves a port or haulage agreement with a related party of Aurizon Network. Anglo American supports the proposed drafting of QRC (see attached Clause 6.10 of Part 6 at Schedule 1).

7.7 Access Charges and Access Conditions

Aurizon Network has sought to remove the provisions that govern the circumstances in which Access Conditions be imposed (as per clause 6.5.2 – 6.5.5 of UT3) in particular:

- (a) Specifications setting out whether Access Conditions may be imposed;
- (b) Requirements to utilise additional revenue for specified purposes;
- (c) Restriction on Access Conditions for expansions;
- (d) Requirement to keep an Access Conditions Register;
- (e) Approval process for Access Conditions; and
- (f) Restrictions on terms of access that require a Significant Investment; and
- (g) Prohibited Access Conditions.

Anglo American submits that there is no reason why such governing provisions should be removed, and in doing so, Aurizon Network is seeking to remove the regulatory oversight of the terms in which it may enter into discussions in relation to Access Conditions with future users. Anglo American submits that provisions 6.5.2 – 6.5.5 of UT3 be included in UT4 in their entirety. As these provision should be reinstated in the same form as outlined in UT3 we have not provided any suggested drafting.

7.8 Schedule F

Definition of Reference Train Services

The definition of Reference Train Service in Schedule F for the Blackwater and Goonyella lines has been amended to eliminate train services that use diesel traction, other than those from Rolleston or Minerva. Anglo American considers it essential that all diesel users are reinstated as Reference Train Services. The removal of diesel trains could result in differentiated tariff for these services under the current proposed UT4 and require access holders and Access Seekers to either accept unfavourable terms or to individually enter into a dispute Aurizon Network.

Anglo American support the QRC's position that where a differentiated tariff is justified on the basis of traction choice, then a diesel reference train service and appropriate reference tariffs should be developed in accordance with the provisions of the amended Ut4. Anglo American further submits that any differentiated tariff should be settled on the terms of the UT4 as set out in Schedule 1 of this submission.

Aurizon Network has, in its reply submission, suggested they will revert the definition of Reference Train Service to either electric or diesel trains. Anglo American is supportive of this amendment being properly reflected in the approved UT4.

Coal Loss Mitigation

In setting out the general operation characteristics for a Reference Train Service (clause 1.3(b)(ix) Schedule F UT4) Aurizon Network has included a requirement to comply with the Coal Loss Management Standards as published by Aurizon Network from time to time. Anglo American notes that it has previously provided a submission to the QCA in relation to the coal loss mitigation in the context of the Rail Connection Agreement setting out the following:

- (a) There has been a long and detailed history of negotiations between Aurizon Network, the coal producers and the relevant Government Departments which has led to an agreement on the Aurizon Network's Coal Dust Management Plan, dated 22 February 2010 (**CDMP**);
- (b) Anglo American believes that it is inappropriate for Aurizon Network to impose obligations which are higher, different or additional to the obligations that industry have agreed to under the CDMP (which is likely under the proposed arrangement, whereby Aurizon Network can implement and update the Coal Loss Management Standards as it determines in its sole discretion from time to time); and
- (c) Any proposed Coal Loss Management Standards that seek to supersede the agreed CDMP should be set out in their entirety in a draft amending access undertaking and not, as is the case here, simply referenced in an undertaking, allowing Aurizon Network to set out any such rules that it requires, which Anglo American notes have to date been viewed as unreasonable by both industry and the QCA.

It is understood that load profiling is a safety requirement and not relevant to the CLMP. However, the profiling requirement should also be included in the relevant undertaking so that the requirement and any future changes can be managed in a transparent way.

Anglo American maintains this position and submits that clause 1.3(b)(ix) of Part 6 in Schedule F in UT4 should be deleted.

Even Railings

Aurizon Network has added additional requirement in clause 1.3(e)(ii)(A) of Schedule F that all Reference Trains Services shall operate their Train Service Entitlements evenly on a weekly and monthly basis in accordance with monthly distribution published by Aurizon Network each year. Previously the distributions were set out in the Network Management Principles in the UT3. By removing them from the terms of the undertaking Aurizon Network is again seeking to remove the regulation of its activities. This clause should be drafted to reflect the previous clause 1.2(b) of Part B Schedule F of UT3.

Take or Pay regime

Aurizon Network has sought to expand the list of matters that are excluded from constituting 'Aurizon Network Cause'. Under the proposed drafting TOP obligations would not be suspended where the shortfall arises from an Access Holder, Railway Operator or a Railway Operator's customer, as opposed to the regime under UT3 where the exclusion was limited to shortfall arising from the Access Holder. It is unreasonable to shift the onus onto access holders where the shortfall arises from the actions of another user of the operator. Aurizon Network is able to recover any revenue through the revenue cap adjustment.

AT₅ and EC

Anglo American supports the view of the QRC that the proposed changes to AT₅ and EC should not be implemented, instead UT4 should revert to the framework utilised for UT3. We have set out detailed analysis of this issue at paragraph 13 of this submission.

Annual Review of Reference Tariffs

Anglo American supports the view of the QRC that:

- (a) Recovery of costs from electrical retailers from all users of the rail network rather than the users of electric infrastructure;
- (b) Aurizon Network desire to incentives electric rail under UT4 is prejudicial against current users of non-electrified rail;
- (c) Audit costs should be incurred by the QCA and recovered through the QCA levy;
- (d) Proposed amendments to the calculation of the increment provides upside to Aurizon Network with no additional risk. The increment should be deleted until an incentive regime is agreed between the parties;
- (e) The ability of Aurizon Network to submits amendments to the calculation of the increment should be removed until the parties agree on an incentive mechanism;
- (f) The QCA should be able to submit a reference tariff variation if Aurizon Network fails to meet its requirements under clause 5.1(a)(ii)(1); and
- (g) Variations in maintenance costs and tenders work in excess of 2.5% should be removed as review events for Reference Tariff Variations.

8 Part 7: Capacity allocation and management

8.1 Aurizon Network response to stakeholders

Short term capacity transfer

In response to industry's request for a short-term capacity transfer process, Aurizon Network has not provided an adequate response. Although Aurizon Network has suggested that it is proposing to introduce a short term swapping mechanism, Anglo American has not seen any aspect or proposed drafting of this mechanism and as such, cannot be assured that the mechanism will deal with the necessary process that industry was hoping to implement. While Aurizon Network has provided some details in its response to stakeholders, Anglo American is concerned that the provisions Aurizon Network has outlined will not be able to cope with the necessary immediacy required of a short term transfer process, including the requirement (as suggested by industry) that the process could be approved in 48 hours.

Matters to be assessed for utilisation of Access Rights

Anglo American strongly disagrees with Aurizon Network's refusal to provide any further comment on the matters to be assessed to demonstrate full utilization of Access Rights. While Aurizon

Network argues that clause 7.2 of UT4 is objective, Anglo American disagrees and believes that it contains highly subjective elements. These include an Access Seeker having to provide evidence of:

- (a) 'sufficient facilities' to enable the use of the relevant Capacity; and
- (b) 'sufficient anticipated output' from the mine to support utilisation of the relevant Capacity.

With both of these elements, it is left to Aurizon Network's subjective judgment to determine what is a 'sufficient' level and Anglo American suggests removing these requirements altogether. This allows utilisation of Access Rights to be determined by fact and does not disadvantage Aurizon Network from the position that it has already taken; ie, that it applies an objective test.

Even if the QCA considers that these requirements are in some way necessary, Anglo American believes that the focus should remain on creating a truly objective test; eg, where an Access Seeker simply has 'facilities (including Rollingstock, provisioning facilities, maintenance facilities and storage facilities) to enable the Access Seeker to utilise the relevant Capacity' and 'at least 80% anticipated usage of the relevant Capacity'.

Further, Aurizon Network suggests that it agrees with industry's suggestion that clause 7.2 should be expressed as the 'reasonable likelihood of utilisation at the time the Access Rights are expected to be used. Anglo American supports this drafting. Alternatively, Anglo American supports the QRC's suggested amendment to clause 7.2, in particular:

7.2 General requirement for allocation

Despite any other provision in this Undertaking, Aurizon Network may refuse to allocate Available Capacity in respect of an Access Application if the Access Seeker has not demonstrated to Aurizon Network's satisfaction (acting reasonably [and in good faith](#)) that the Access Seeker can fully utilise the Access Rights requested. [An Access Seeker can fully utilise the Access rights if it has:](#)

- (a) Supply Chain Rights;
- (b) [a reasonable likelihood of obtaining](#) a contract for rail haulage utilizing the relevant Capacity [by the time the Access Rights are to commence](#);
- (c) where the relevant Capacity will be used to transport the output of a mine, sufficient anticipated output from the mine to support full utilisation of the relevant Capacity; and
- (d) if relevant, rights from other providers of infrastructure (for example, unloading facility operators and other Railway Managers) to use infrastructure necessary for the Access Seeker's Train Services to enter and exit the Rail Infrastructure.

[It is acknowledged that at the time of allocating Available Capacity it is not necessary for paragraphs \(a\) to \(d\) to have been complied with, and that it is sufficient for the Access Seeker to have a reasonable likelihood of satisfying paragraphs \(a\) to \(d\) by the time that the Access Rights are to commence.](#)

Reinstatement of the 'replacement mine' concept

Anglo American supports Aurizon Network's decision to reinstate the 'replacement mine' concept, however, disagrees with Aurizon Network's redefinition. Requiring the replacement mine to utilise the same capacity as the existing mine undermines the concept altogether: rather than being a replacement, Aurizon Network is essentially amending the concept so that no mine can be replaced because it is extremely unlikely that a new mine will ever have exactly the same point of origin. As such, the redefinition proposed by Aurizon Network should not be accepted and the 'replacement mine' concept should be reinserted as it was drafted in UT3, namely that it is:

- (a) in the same geographic area as the existing mine;

- (b) uses substantially the same train paths as the existing mine; and
- (c) producing substantially the same output as the existing mine.

Anglo American supports reintroducing the definition of a 'replacement mine' with the same effect as UT3, specifically:

'Replacement Mine means a mine':

- (1) that the Customer or Access Holder which is the same as the Customer Access Holder (as applicable) for the existing mine receiving the benefit of the relevant Access Rights:
- (2) that is in the same geographic area as the existing mine referred to above such that Train Services for that mine use substantially the same Train Paths as Train Services for the existing mine; and
- (3) that is producing a volume of coal substantially equivalent to a reduction in existing volume from the existing mine.

Renewals

Anglo American supports the requirement in clause 7.3(d) for Aurizon Network to 'promptly negotiate' with a renewing Access Seeker. In the Aurizon Network Reply Submission, Aurizon Network states that it cannot maliciously or recklessly delay negotiations without breaching the Undertaking or the QCA Act. Whilst this may be true, an innocent delay at the beginning of the time period may have consequences and Anglo American remains of the view that Aurizon Network should promptly commence and undertake negotiations.

Anglo American does not support Aurizon Network's continued insistence that renewing Access Seekers should be required to resubmit an entirely new Access Application. While Anglo American notes Aurizon Network's argument that Access Applications allow Aurizon Network to receive sufficient information, the relevant information is generally provided throughout the course of the Access Agreement and Aurizon Network need not require a full Access Application. Rather, as it is drafted clause 7.3 allows Aurizon Network to completely recommence negotiations for Access Rights on substantially different terms and undermines the regulatory certainty for Access Holders / Customers who require long-term certainty of the security of their rights for the life of a mine (as the basis for important investment, development and financing decisions and approvals).

Further, Anglo American believes that there should be a specific right to renew for Access Holders that continue to meet the relevant objective criteria for access. Anglo American cannot stress enough that large mining companies make major investments considering the entire life of well up to 30+ year mine development programs. This is well in excess of the standard 10 year term of Access Agreements. As such, miners depend on the continuing commitment to access provided by Aurizon Network. In situations where a user has not breached its Access Agreements, has abided by the provisions of the relevant Access Undertaking, and has agreed to commit to the further timeframe required by Aurizon Network.

However, users should be afforded an opportunity to align the term of their rail access and port commitments so as to avoid unnecessary exposure to 'Take-or-Pay' but at the same time not lose their renewal rights in having to renew for 10 years or 'life of mine' whichever is the lesser.

Anglo American does not see how a requirement to renew is of detriment to Aurizon Network. Rather, a requirement to renew allows for certainty in the continuity of the Queensland coal network and the supply chain that Queensland miners rely on. This will increase investment in the Queensland coal market, increase mining opportunities, and in the long-term increase the revenue derived from this increased investment by Aurizon Network.

As such, Anglo American strongly submits that:

- (a) renewing Access Holders should have a clear right to maintain their existing Access Rights; and
- (b) those renewing Access Holders should not be required to submit a full Access Application where their renewed rights are substantially the same as under their existing Access Agreements.

Expedited transfer process

In Aurizon Network's response to stakeholders it has only agreed that it will 'include an obligation in the compliance report in Part 10 to report on the average negotiation period for transfers'.¹¹

This does not address industry's concern. Rather, industry has requested that Aurizon Network develop a process that can expedite the transfer of capacity. Simply including a reporting requirement gives industry no provision to ensure compliance, or even certainty as to what the transfer timeline will be when dealing with short term capacity transfers.

On this point, Anglo American supports the QRC's drafting in respect of timelines for transfers (in particular, the QRC's proposed clause 7.4.2(e) and (f)).

Requirement to execute a transfer

Anglo American notes that Aurizon Network has not addressed the QRC's submission regarding a standard requirement to execute a Transfer. Anglo American strongly supports this suggestion by the QRC as it does not disadvantage Aurizon Network, allows expeditious conclusion of Transfer Agreements and ensures an Access Holder's ability to appropriately deal with their contracted Capacity.

Works required for Access Rights

Anglo American agrees that clause 7.5.2(b) requires redrafting, however, does not necessarily agree with the drafting amendments proposed by Aurizon Network. In particular, as Anglo American has suggested previously, the QCA has the power to require Aurizon Network to undertake mandatory expansions. This should include a clause requiring Aurizon Network to undertake expansions for less than \$300 million where that will achieve enough Available Capacity for any Mutually Exclusive Access Applications that Aurizon Network has received. Anglo American suggests the following drafting:

7.5.2 Capacity allocation for Mutually Exclusive Access Applications

...

- (b) If Aurizon Network has received Mutually Exclusive Access Applications for Available Capacity, then Aurizon Network will enter into negotiations for Access Agreements (including any agreements to allow Access Rights to be exercised or created – for example a Connection Agreement) for the Available Capacity for those Access Applications that meet the following criteria prior to considering any of the other Access Applications:
 - (i) the Access Application is for a coal carrying Train Service;
 - (ii) the Access Seeker has ~~satisfied Aurizon Network (acting reasonably) that the Access Seeker will be able to use~~ identified how it intends to utilise the Access Rights ~~at the level being~~ sought giving consideration to the factors in **clause 4.11(c)**;

¹¹ Aurizon Network, *Detailed response to undertaking and schedules (volume 1)* (2013) 85.

(iii) the grant of the Access Rights is not subject to any Expansion or Customer Specific Branch Line, except to the extent that an Expansion is otherwise required by this Undertaking (in particular, where Aurizon Network is required to complete an Expansion under clause 8.2.1(b) or 8.2.1(c) or other works or expenditure by Aurizon Network relating to the Rail Infrastructure;

[Drafting note: this reflects Anglo American's suggested amendments to Part 8]

(iv) the Access Rights requested could be used without adversely affecting the ability of existing Access Holders to use their Access Rights;

(v) the Access Agreement's proposed term is at least 10 years or the remaining life of the mine; and

(vi) where the grant of Access Rights requires Existing Capacity that will become Available Capacity, Aurizon Network is satisfied (acting reasonably and in good faith) that the Access Seeker has a reasonable likelihood of being able to utilise that Existing Capacity at the time when it becomes Available Capacity, specifically by considering the same criteria as in clause 7.2.

Removal of 'first in time' and 'queue'

Anglo American does not agree with Aurizon Network's drafting of clause 7.5.2(d), or with the QRC amendments. There has been a fundamental policy shift in Aurizon Network's drafting of the requirements for determining between Mutually Exclusive Access Applications and Anglo American strongly disagrees with this.

Rather, Anglo American is concerned that important objective concepts of UT3 have been removed and replaced with the subjective criteria that Aurizon Network has worked into clause 7.5.2(d). The important concepts that have been removed are:

- (a) the concept that a Mutually Exclusive Access Application (meeting all the relevant criteria) lodged first in time has priority where that Access Seeker has met the reasonable offtake requirements. Anglo American notes that the only *truly objective* criteria for distinguishing between Mutually Exclusive Access Applications are the 'first in time' concept and the need to have sufficient offtake requirements to properly utilise the Capacity sought; and
- (b) the development of a queue for later Mutually Exclusive Access Applications, which acts to preserve the timing (and, subsequently, priority) of those Access Seekers.

Anglo American submits that the relevant sections, both applying the first in time rule and forming the queue for Mutually Exclusive Access Applications, should be returned to UT4.

Matters for consideration in Mutually Exclusive Access Applications

Further, while access regulation has been implemented in order to protect against the natural monopoly created when QR was sold off by the State, Aurizon Network continues to consider that it is appropriate to focus on the importance of its legitimate business interests and to ensure its revenue adequacy. This is completely inappropriate because:

- (a) as discussed in Anglo American's first submission on UT4, there are numerous instances where Aurizon Network's legitimate business interests might not actually be aligned with the provisions and principles underlying the regulation of the CQCN. While Aurizon Network does have duties to represent its own interests as well as those of its shareholders, by virtue of its position as a natural monopolist, these interests must not be elevated above the adherence to approved regulation as that will (whether acted on or not) allow for abuse of the natural monopoly position; and

- (b) revenue adequacy is simply not a concern for Aurizon Network as a business. Under its form of revenue-cap regulation, the QCA sets the Maximum Allowable Revenue for Aurizon Network as a regulated entity and, while it is not entitled to earn over that amount, it is also extremely unlikely that (without fraud, dishonesty or negligent acts on Aurizon Network's behalf) it will earn less than that value. While a price-cap form of regulation allows Aurizon Network to potentially earn a greater amount during a financial year, it also causes Aurizon Network to bear more risk and it is in the value of the extra risk that Aurizon Network might legitimately be able to consider its revenue adequacy. Aurizon Network has chosen to continue to implement the revenue-cap form of regulation, to bear almost zero risk on the entire CQCN, and as such receives a comfortably consistent rate of return. As such, Aurizon Network's revenue adequacy is simply not a credible consideration when deciding between Mutually Exclusive Access Applications and should be removed from UT4.

8.2 The Network Management Principles

In its first submission on UT4 Anglo American dealt at length with the application, role and development of the Network Management Principles. Anglo American notes that in its response to stakeholders, Aurizon Network made very little attempt to address the numerous issues and clarifications raised by Anglo American for the benefit of the operation of the CQCN. Anglo American strongly reiterates its original submissions (see section 8 of the Anglo American October 2013 Submission on Aurizon Network's 2013 Draft Access Undertaking) in relation to the Network Management Principles, including its proposed redrafting of Schedule H. Anglo American has attached its redrafting of Schedule H at Schedule 1 to this submission for further consideration. Anglo American has also attached at Schedule 3 its explanatory notes on the interactions of the various operational documents in order to assist the QCA's consideration of this submission.

In relation to Aurizon Network's response to stakeholders on the Network Management Principles and the System Rules (and relevant sections of clause 7.6), Anglo American is concerned with a number of specific arguments made by Aurizon Network.

Primarily, Anglo American is concerned that while Aurizon Network notes that its requirement to comply with the Network Management Principles has been included in the access agreement, this means that subsequently the QCA does not have the power to interpret or to enforce common law contracts. Historically, this has never been the case. Under UT3, the obligation for Aurizon Network to comply with the duly constituted Network Management Principles was clearly stated in clause 7.1(a), allowing QCA oversight and Aurizon Network's adherence to this important organisational document. As such, the only reason that Aurizon Network's specific obligation to comply with the Network Management Principles has been moved to the access agreement (where there is no industry or QCA oversight) is that Aurizon Network has redrafted it that way.

As such, Anglo American completely disagrees with the argument or proposal put forward by Aurizon Network in an attempt to address this concern. The Network Management Principles are an important part of the scheduling and delivery process. If the right / obligation to rely on, and be bound by, the Network Management Principles is not in the Undertaking, then an element of the capacity allocation process is taken out of public view / review. Anglo American strongly believes that the Network Management Principles are important obligations to ensure compliance with, particular if there is (as Aurizon Network has stated numerous times) 'scarce capacity' available for Access Holders and Access Seekers.

Anglo American sees absolutely no reason why this obligation rests in the access agreement where Aurizon Network may negotiate out of any obligations to comply with the Network

Management Principles without any regulator or other Access Holder / Customer being aware. As such, Anglo American strongly submits that clause 7.6.1 of UT4 should include the following clause:

7.6.1 Compliance with the Network Management Principles

(a) Aurizon Network will:

(i) perform scheduling, Train Control and associated services; and

(ii) provide capacity related information to Access Holders; or

(iii) provide capacity related information to Customers,

in accordance with the Network Management Principles.

(b) An Access Agreement will include obligations for the Access Holder and Aurizon Network to comply with Network Management Principles in accordance with clause 7.6.1(a).

8.3 The System Rules

Drafting of the System Rules

Anglo American supports Aurizon Network's response that it will reintroduce a clause requiring each System to have System Rules. Anglo American notes that Aurizon Network has (over an extended period of time) submitted System Rules for Goonyella, Capricornia and the Northern Bowen Basin. As Aurizon Network has taken the opportunity to point this fact out, Anglo American questions why Aurizon Network wished to remove the clause requiring compulsory System Rules in its initial drafting of UT4, however, it also agrees that the clause should be reinserted. These System Rules have been released with varying levels of consultation and consideration and Anglo American has made extensive submissions on each. Anglo American supports the QRC's suggested drafting amendments, specifically:

7.6.3 Making the initial System Rules for a Coal System

- (a) Where System Rules do not already exist for a Coal System, ~~and~~ Aurizon Network must promptly ~~wishes to~~ develop the initial System Rules for that Coal System. In doing so, it will consult with Access Holders, Railway Operators and Access Seekers whose Train Services will be affected by the System Rules, and any affected Infrastructure Service Providers, in relation to the introduction of the System Rules.
- (b) After consulting under **clause 7.3.6(a)**, if Aurizon Network ~~decides to make initial System Rules for that Coal System, then it~~ will:
- (i) prepare the proposed System Rules (***Draft System Rules***) having regard to the equitable operation of the System Rules across Access Holders and Access Seekers (should they become Access Holders) and their Customers and the terms of Access Agreements;
 - (ii) in preparing the Draft System Rules, ~~seek to~~ ensure that they do not conflict with the Network Management Principles or any provision of this Undertaking;
 - (iii) act reasonably and in good faith when preparing the Draft System Rules; and
 - (iv) submit the Draft System Rules to the QCA for approval.
- (c) Where Aurizon Network has submitted Draft System Rules to the QCA, the QCA must consider the Draft System Rules and notify Aurizon Network that it either approves or refuses to approve the Draft System Rules. The QCA may decide, at its own discretion, to request and consider public submissions on Aurizon Network's Draft System Rules.
- (d) If the QCA refuses to approve the Draft System Rules, then:

- (i) the QCA will set out its reasons for doing so in any notice to Aurizon Network Network of that decisions; and
- (ii) Aurizon Network ~~may choose to will~~ resubmit the Draft System Rules ~~either amended, or with additional information,~~ to address the matters in the QCA's reasons without having to further consult under **clause 7.6.3(a)**.

Amendments to the System Rules

Anglo American notes that Aurizon Network has not addressed the amendment provisions suggested by the QRC in its initial submission. The majority of these suggestions relate to Aurizon Network's ability to review and amend the System Rules without any form of industry consultation or regulatory oversight. As Anglo American noted in its September 2013 submission on the Northern Bowen Basin Draft System Rules:

Aurizon Network has a broad and unfettered ability to implement unilateral amendments to the [System] Rules. This process should be amended to include a compulsory consultation process, an objection and suggestion process and submissions which should be reviewed by the QCA. If these limited consultative measures are not included, the operation of industry regulation (UT3/UT4) will hardly extend to Aurizon Network under the [System] Rules.

Anglo American further commented on this issue in its August 2013 submission on the Capricornia Draft System Rules that:

...there is a distinct lack of clarity or power in the amendment process that allows users to object to amendments to the [System Rules]. Aurizon Network may implement unilateral changes to the [System Rules] and users can only object using the lengthy dispute resolution process contained in UT3, without any timely recourse or consideration of their objection. Further, operators have no right to object at all. Whilst this might be consistent with the requirements of UT3, at the time that UT3 was approved there was no thought that the system rules would affect the legal rights and obligations of the coal producers. In light of the importance of the system rules and the impact on users, this process needs to be rectified so that the essential entities involved in the operation of the Capricornia System can play a part in dynamic developments to the [System Rules].

Whilst in that context, Anglo American was suggesting amendments to the System Rules themselves, it also believes that these same issues can (and should) be addressed in the drafting of UT4. Anglo American strongly supports all of the QRC's drafting amendments for clause 7.6.4, specifically:

7.6.4 Amending the System Rules

...

- (b) After consulting under **clause 7.6.4(a)** Aurizon Network will submit its Proposed Amendments to the QCA for approval.
- (c) Where Aurizon Network has submitted Proposed Amendments the QCA must consider the Proposed Amendments and notify Aurizon Network that it either approves or refuses to approve the Proposed Amendments. The QCA may decide, at its own discretion, to request and consider public submissions on Aurizon Network's Proposed Amendments.
- (d) Any relevant party (including stakeholders, Access Holders, End Users or possible future Access Seekers) may object to any Proposed Amendment submitted by Aurizon Network. An objection may be made in writing to the QCA.
- (e) If the QCA receives a written objection to a Proposed Amendment it must request and consider public submissions.
- (f) If the QCA refuses to approve the Proposed Amendments, then:

- (i) the QCA will set out its reasons for doing so in any notice to Aurizon Network of that decision; and
- (ii) Aurizon Network must resubmit the Proposed Amendments amended to address the matters in QCA's reasons without having to further consult under clause 7.6.4.

...

Review of the System Rules

Anglo American notes that Aurizon Network has committed to an annual review of approved System Rules. Anglo American supports this, although submits that it does not provide enough guidance on when it should be necessary to review the System Rules. For example, while Aurizon Network has agreed to insert a clause requiring review when there is a greater than 30% change in GTKs, this does not initiate the review soon enough. Rather, another clause should be inserted enabling a review mechanism when there is the connection of a new coal basin; for example, a pre-emptory review required in order to ensure that the System Rules are appropriate for dealing with the doubling of capacity predicted on the Newlands system if the Galilee basin is connected. A similar requirement should be included in instances where new port terminals are created, or old port terminals reach capacity as this will also affect the entire operation of the system supply chains and, subsequently, the System Rules.

A similar approach should be taken when there is a change or amendment to the System Operating Assumptions or the Network Management Principles. As these documents either inform or are informed by the provisions of the System Rules, it is essential to reconsider the principles in the System Rules when the subsequent information changes.

Finally, Anglo American also strongly submits that there should be a provision inserted in clause 7.6.4 triggering a review of the System Rules when at least 60% of Access Holders in a system request a review. These rules impact Access Holders' operations as much as Aurizon Network's and leaving Access Holders with no ability to request reviews where vital elements of their business or industry change is inappropriate.

As such, Anglo American reiterates the drafting proposed by the QRC and proposes some further amendments, specifically including:

7.6.5 Compulsory review of the System Rules

- (a) In instances where:
 - (i) system capacity increases by greater than 30% of the existing capacity;
 - (ii) an expansion is required to increase system capacity by greater than 30% of the existing capacity;
 - (iii) a new coal basin becomes (or is reasonably likely to become) connected to a system;
 - (iv) a new port terminal or unloading facility becomes (or is reasonably likely to become) connected to a system;
 - (v) there is a material change to the System Operating Assumptions or the Network Management Principles which subsequently affects the operation of the System Rules; or
- (iii) at least 60% of the Access Holders in a Coal System formally request a review by written notice to Aurizon Network.

Aurizon Network is required to commence a review of the relevant System Rules for the affected system.

(b) Aurizon Network is required to submit a reviewed copy of the System Rules to the QCA for approval in accordance with this clause 7.6.

(c) Aurizon Network is required to notify Access Holders, End Users and Train Operators who will be affected by the increased capacity.

(d) In making its decision to approve or reject the reviewed System Rules, the QCA is required to request and consider any submissions received from a person notified under clause 7.6.5(c).

9 Part 8: Network Development and Expansions

9.1 The QCA power to require mandatory expansions of the CQCN

Anglo American again notes that the QRC has not considered the QCA's ability to require Aurizon Network to complete mandatory expansions. As such, Anglo American reiterates the submissions that it made in the Anglo American First Submission (see particularly section 7.1). Further, in order to assist the QCA process in assessing Part 8 of UT4, Anglo American has completed extensive drafting amendments to Part 8 showing the amendments that it would make for the proper operation of the regulation. This is attached at Schedule 2.

Anglo American has made numerous submissions concerning the current viability of commercially negotiated agreements between Aurizon Network and industry. In particular, in relation to SUFA Anglo American notes the extreme difficulty and time taken to progress to a stage anywhere near to an outcome. As stated in the Anglo American First Submission:¹²

Whilst Anglo American believes that a commercially negotiated outcome is ideally a better solution than a regulatory outcome, it does not currently believe that this is possible with Aurizon Network given the nature and structure of its parent company's business and aspirations. As such, SUFA (or any other form of commercially negotiated Expansion) is not a valid substitute for the current mandatory Expansion mechanism.

Further, in its October 2013 submission Anglo American noted that the concept that regulators may impose mandatory Expansion regimes has been considered and suggestively applied to other major regulators in Australia. In particular:

In its Draft Report on the Review of the National Access Regime the Productivity Commission found that it was entirely appropriate to empower a regulator to require mandatory investment. In particular, the Productivity Commission noted that without a power to direct capacity expansions, the regulator (in that case, the ACCC) would have no ability to enforce its efficiency objective, which is the central obligation of any competition regulator. Part 5, section 69E of the QCA Act contains the specific efficiency objective for the QCA in relation to determining access to services and is effectively a mirror of Part IIIA section 44AA of the Competition and Consumer Act 2010 (Cth) (CCA), which the Productivity Commission was referring to in its Draft Decision on the Review of the National Access Regime.

Further, Anglo American agrees with the comments of RTCA that:

In seeking to remove these protections (and which in the case of the minimum investment commitment was given only 4 years ago), Aurizon Network would severely undermine regulatory predictability and certainty at a time when investment confidence in the Queensland coal industry is already fragile, given global cost and supply challenges.¹³

¹² See also Anglo American, *Submission on the 2013 Standard User Funding Agreement DAAU* (August 2013) 1.

¹³ RTCA First Submission, 48.

Anglo American's proposal is that the mandatory expansions regime present in UT3 be maintained, even past any industry agreement on SUFA (or a substantially similar concept). This reflects the principles in clause 7.5.4 of UT3, namely that Aurizon Network is required to complete any Expansions that:

- (a) consist of replacement capital expenditure;
- (b) are needed to provide Access Holders, whose Access Rights are conditional on the completion of an Expansion, with additional Access Rights where the Expansion did not result in sufficient Capacity to satisfy all Access Holders with conditional rights;
- (c) are needed to reduce a deficit between Capacity and Committed Capacity caused by a change in System Operating Assumptions; or
- (d) are required to create sufficient Available Capacity to provide Access Rights sought by an Access Seeker unless the Expansion is:
 - (i) a Customer Specific Branch Line; or
 - (ii) greater than \$300 million (adjusted for inflation),except to the extent that such an Expansion is a user-funded Expansion.

In Anglo American's extensive redrafting of Part 8, these provisions can be seen at clauses 8.2.1(b) and (c) of Part 7 at Schedule 1.

While Anglo American firmly believes that the majority of these Expansions should be completed at the regulated WACC, it does acknowledge that in certain instances Aurizon Network may be required to take additional risks on a mandatory Expansion. In its October 2013 submission (and further below), Anglo American considered the concept of the 'split cost of capital', as well as specifically considering the application of expansion pricing principles in section 7.2; Anglo American refers the QCA's attention back to these submissions. Such a system would reward Aurizon Network where it has adopted risk above the regulated WACC, and also ensure that the standard WACC reflects the true risk profile of the CQCN. Anglo American notes that such a concept would be appropriately applied as an element of the mandatory Expansions regime and could ensure that Aurizon Network is not disadvantaged by its operation.

RTCA considered a similar concept in the RTCA First submission, arguing that UT4 should 'retain existing funding obligations, including both the \$300m capital expenditure commitment and the "access conditions" process.'¹⁴ While Anglo American fully supports this, it does not agree with RTCA's other suggestion, to restrict any above regulated return.

On the contrary, Anglo American submits that both the access conditions and mandatory expansions process '*must*' be reinserted, and that where Aurizon Network accepts a risk profile above the CQCN, it should be adequately rewarded for that. Rather than restricting Aurizon Network's return to the regulated rate, Anglo American believes that Aurizon Network should receive compensation for the risk that it accepts. Anglo American notes that through numerous risk avoidance measures in UT3, as well as a large number of further risk avoidance mechanisms inserted in UT4, Aurizon Network has not adequately adopted risk to achieve above the regulated rate of return.

Anglo American notes that relying on the as-yet far from completion SUFA suite to replace the mandatory Expansions regime is simply not appropriate. Rather, the majority of Expansions required under the mandatory Expansions regime are of a nature that would not be picked up (or even considered) under SUFA, and may otherwise be ignored. In particular, any Expansion totalling less than \$300 million should not be mired in the extensive and time-consuming

¹⁴ RTCA First Submission, 37.

negotiations that will inevitably surround SUFAs. An Expansion for less than \$300 million will generally be a minor enhancement to the CQCN which will be extremely unlikely to differ from the general risk profile of the CQCN. On the other hand, as Anglo American understands the SUFA suite, it should be for use in major developments such as the connection of GAPE-like infrastructure that costs AUD\$ billions and will involve considerable time, effort and cost.

Otherwise, the restricted instances where Anglo American's redrafted Part 8 requires Aurizon Network to complete mandatory Expansions are in areas where Aurizon Network has almost sole control of the risk. For example, it is appropriate to require Aurizon Network to rectify a deficit between Capacity and Committed Capacity in instances where (as has historically occurred) Aurizon Network has over-contracted part of the network.

Anglo American relies on its extensive redrafting of Part 8 to convey its further understanding and approach to the necessary mandatory Expansions regime.

9.2 Application of Aurizon Network's capex voting process

Anglo American considered the importance of the voting system for capital expenditure in its October 2013 submission on UT4. In particular, Anglo American was concerned that the voting process as drafted in UT4:

- (a) *Aurizon Network does not provide sufficient information to allow users to adequately assess the need and prudence of any proposed capital expenditure – this was seen particularly in respect the vote on the electrification of the Blackwater System which Aurizon Network then sought to 'socialise' across the Goonyella users as well; and*
- (b) *an abstinence of a vote is deemed to be a 'yes' vote – particularly in circumstances where there is insufficient information a user may be reluctant to actually vote no (or alternatively may not feel like they cannot adequately articulate why they wish to vote no).*

Anglo American's position in the Anglo American First Submission was echoed in other submissions. Anglo American notes the comments made in the RTCA First Submission, that:

A genuine, commercially balanced customer vote process should form a standard feature of all major capital expenditure projects the cost of which is intended to be socialised across users through regulated tariffs.¹⁵

Anglo American reiterates its support for the QRC voting process as discussed in the QRC's initial submission on UT4 (page 70-71), however, again submits that an abstention with reasons (eg, lack of adequate information to make an informed decision binding that user) should count as a 'no' vote.

Aurizon Network has addressed this point in its response to stakeholders' submissions, however, Anglo American is not hopeful that it has been (or will be) given adequate consideration. Anglo American agrees that in instances where a user votes 'no', there should be a requirement to provide reasons for its no vote. Similarly with an abstention or failure to vote, it is understandable that Aurizon Network would wish to receive more information on a user's decision to vote in that manner. Anglo American argues, however, that an important reason for allowing a 'no' vote or abstention is that a user does not feel that it has received enough information to enable it to make an informed vote either way.

Anglo American's view is that only failure to vote is treated as an abstention.

Aurizon Network has explained that its 'intent in deeming [a failure to vote as] a "yes" vote is to encourage the lodgment of a vote either way.' While Anglo American acknowledges that this is a respectable intent, Aurizon Network's current voting process does not achieve that. Rather, it

¹⁵ RTCA First Submission, 7.

generates a perverse result which has no grounding in users' actual opinions and might convince Aurizon Network to undertake imprudent or unnecessary capital expenditure which it later attempts to claim back through Access Charges by relying on the 'fact' that users voted in favour of the relevant project.

This is a dangerous and potentially extremely expensive error in the voting process that should be corrected (as discussed above) before the approval of UT4. While Aurizon Network has agreed to review its current drafting, Anglo American fears that the exact reasons for excluding Aurizon Network's unilateral deeming procedure are not fully understood and the redraft may not address these extremely valid concerns.

9.3 Reintroduction of the Access Conditions Regime

As stated in its first submission, Anglo American has always strongly supported the existence and operation of the Access Conditions regime under UT3. While there have been elements of the regime that have not been particularly effective throughout UT3, the QCA now has the opportunity to refine and perfect the process.

The access conditions regime benefits:

- (a) users by ensuring that they understand the only restrictions that can be placed on them through negotiations with a natural monopolist, and generating regulatory certainty when making investment and financing decisions; and
- (b) Aurizon Network by rewarding prudent investments, or protecting it from the damage of risky investments made on behalf of a particular user.

As such, Anglo American does not support the removal of the access conditions regime. Once more, Anglo American reiterates its previous comments submissions on the 2013 Standard User Funding Agreement Draft Amending Access Undertaking that:

[T]he QCA should not allow Aurizon Network to remove (or even dilute) the Access Conditions regime that is present in UT3 (currently Part 7 of UT3)... Anglo American notes that Aurizon Network proposes to remove the Access Conditions regime from [UT4] (evidenced by Part 8 of its 2013 Draft Access Undertaking submission) and Anglo American is concerned that Aurizon Network will argue that the Access Conditions regime is not necessary because of the SUFA.

Anglo American also notes that Aurizon Network proposes in its draft UT4 submission that even if users are willing to fund an expansion under SUFA, Aurizon Network still has significant discretion regarding whether to approve the SUFA and how it will progress (see clause 8.2.1(a) and (b) of UT4). In particular, clause 8.2.1(b)(ii) of UT4 clearly introduces an economic discretion for Aurizon Network – this is entirely inappropriate. Where the alternative to a SUFA expansion is around 15% return on the capital, which is significantly above the regulated rate of return (as Aurizon Network sought with the Goonyella to Abbot Point Expansion (GAPE) and the Wiggins Island Rail Project (WIRP)), it will always be in Aurizon Network's legitimate business interests to refuse a SUFA. Further, there are no objective circumstances or tests outlined to determine when an expansion will be economically feasible (and no explanation as to why Aurizon Network should determine whether the project is economically feasible when the entire capital outlay is being provided by users). This gives Aurizon Network clear discretion over what should be objective factors leading to the approval of a SUFA and undermines the premise of the entire project. Combined with the removal of all mandatory funding obligations (other than replacement capital), this discretion creates further cause for concern for users willing to invest in extensive expansions to the network.

Aurizon Network also proposes in its draft UT4 submission to have the ability to determine the order in which expansions proceed (if at all). User-funded or not, being part of a vertically integrated business with interests in above and below rail assets and ports means Aurizon Network Holdings would have complete control of the supply chain (including how and when it is expanded), creating clear conflicts contrary to interests of rail access users and seekers, and potentially in breach of ringfencing obligations.

With a completely untested SUFA, if users lose the protection afforded by the Access Conditions regime there will be no ability to force Aurizon Network to complete an expansion on a user's behalf at reasonable expense. Rather, as has already happened to users in negotiations over the GAPE and WIRP, users will be subject to 'economic hold-up' at the hands of Aurizon Network.¹⁶

10 Part 9: Connecting Private Infrastructure

10.1 General

Anglo American notes that in its drafting of UT4, Aurizon Network significantly departed from the general provisions for connecting infrastructure included in UT3. Anglo American does not support Aurizon Network's deviations. Importantly, Anglo American notes that Aurizon Network has given itself far greater control and management over the design and implementation of connecting infrastructure, and reduced the scope of this Part 9 to discourage any form of competitive development or new entrant into the Queensland rail market. This should not be the intention of the section dealing with connecting infrastructure.

10.2 Reduced scope

In general, Anglo American strongly supports the submissions and redrafting proposed by the QRC in October 2013. Specifically, Anglo American agrees that by reducing the application of the connecting infrastructure provisions solely to Access Seekers, Aurizon Network has limited the application of Part 9 and subsequently reduced the scope for the development of the Queensland coal market (at the very least, Aurizon Network's drafting has hampered the incentives of third party infrastructure owners or investors to consider Queensland rail developments). In some ways, Anglo American notes that Aurizon Network's position actually stifles the possibility of growth in competition in this market (being the rail infrastructure market), shoring up Aurizon Network's position as a natural monopolist. Anglo American does not believe that this is the intention of the Access Undertaking.

10.3 Unnecessary ambiguity

Anglo American also supports the QRC's submission that Aurizon Network's drafting of Part 9 introduces unnecessary ambiguity into the process for negotiating or consenting to connecting infrastructure. Anglo American supports the QRC's position that Aurizon Network should be obliged to negotiate for the provision of connecting infrastructure in situations where the owner of the private infrastructure meets certain criteria, similar to the approach taken with the (hopefully) objective test for assessing an Access Seeker.

10.4 Reduction of Aurizon Network liability

Anglo American notes that Aurizon Network has attempted to reduce its liability further in relation to connecting infrastructure, specifically by removing the UT3 provision that made Aurizon Network responsible for loss suffered when it unreasonably delayed entering a connection agreement. This attempt at reducing Aurizon Network's risk or liability is a standard theme throughout the entire drafting of UT4, however, as Anglo American has already noted, the attempt to reduce risk and liability is not matched by a respective drop in Aurizon Network's analysis of its own risk profile or reasonable returns. It is further submitted that using UT3 as the starting point is flawed as it assumes the risk/reward profile was appropriately matched in circumstances where Aurizon Network was able to take advantage of its position under UT3 or failed to implement a number of UT3 aspects which because deferred and remained largely unresolved. Anglo

¹⁶ Anglo American, *Submission on the 2013 Standard User Funding Agreement DAAU* (August 2013) 1-2.

American has addressed a similar point in its July 2013 response to the QCA Pricing Papers, specifically:

- (a) The consequence of these additional changes to the UT3 arrangements is to immunise Aurizon Network from all material risks, whilst at the same time Aurizon Network seeks to increase its Market Risk Premium during the UT4 regulatory period. It is clear that to the extent any of these changes to the UT3 form of regulation and ancillary measures are adopted, the non-diversifiable risk of Aurizon Network would be less than it bore in UT3, and the resulting beta (and WACC) should be reduced accordingly; specifically to be equal to or just above zero; and
- (b) Anglo American notes that while Aurizon Network has made a number of these risk-reducing amendments, these have not been reflected in Aurizon Network's approach to pricing or rate of return. Anglo American submits that this is not appropriate.

Anglo American reiterates the following drafting:

9.5.1 Connecting infrastructure

...

(e) Aurizon Network must pay any reasonable costs incurred by an Access Holder, Access Seeker, Train Operator or third party referred to in clause 9.1(a) to the extent they suffer loss (excluding Consequential Loss) as a result of a delay or failure by Aurizon Network to enter into an agreement referred to in clause 9.1(a) contrary to clause 9.1(a).

Anglo American supports the further drafting amendments proposed by the QRC in an attempt to return the equitable operation of the CQCN, including ensuring that Part 9 is subject to the dispute resolution mechanisms in the Access Undertaking and that changes to the CQCN which subsequently affect capacity or operation of private infrastructure should be discussed and negotiated with the owners and users of that private infrastructure.

10.5 Aurizon Network response to stakeholders

Anglo American notes that Aurizon Network has addressed a limited number of the concerns raised by industry. Anglo American is not convinced that Aurizon Network has dealt with even this limited number of concerns adequately. In particular:

Obligation to permit connection

While Aurizon Network has agreed to replace its requirement for 'consent' with one to 'permit' a connection, it does not appropriately deal with industry's concern regarding the consistency between an agreed rail connection agreement and the Standard Rail Connection Agreement. Aurizon Network suggests that merely requiring consistency with the SRCA is satisfactory, however Anglo American does not perceive any added complexity (and, in fact, notes that there will be greater regulatory certainty) for the undertaking to require a rail connection agreement to, unless otherwise agreed, be in the *form* of the SRCA.

Provision of detailed reasons

While Aurizon Network has seemingly addressed industry's concern regarding reasons for a decision not to negotiate, in reality Aurizon Network has only agreed to redraft the section to suggest that it will 'provide notice to an Access Seeker or third party that Aurizon Network does not believe' the relevant conditions have been complied with. Anglo American submits that this does not address industry's requirement for reasons. The provision of reasons enables the QCA and the relevant Access Seeker or third party to understand Aurizon Network's decision, and to correct, rectify, or dispute the decision where applicable. Anglo American believes that there

should be a clear clause requiring Aurizon Network provide detailed reasons for its refusal to negotiate.

Liability for unreasonable delays

Aurizon Network has refused to accept any liability for its own unreasonable delays, both in entering into a rail connection agreement or physically connecting infrastructure, except as contained in an access agreement. Anglo American has noted numerous other provisions where Aurizon Network has removed a standing requirement of UT3 and inserted them into the access agreement. Anglo American reiterates its argument that removing such important restrictions from the regulated undertaking and placing them in the commercially negotiated access agreement only undermines the regulation of the CQCM. In this instance, Anglo American simply cannot understand why Aurizon Network is unwilling to accept liability for situations where it has sole control over its own ability to enter a rail connection agreement and *unreasonably* delays entering that rail connection agreement. As such, Anglo American supports the QRC's inclusion of this clause (Anglo American makes the same submission in relation to Aurizon Network *unreasonably* delaying the development of connecting infrastructure).

Regulation through the Access Undertaking and not through commercial agreements

Aurizon Network has further argued that the Standard Rail Connection Agreement should cover the obligation to 'notify' (rather than 'consult') with a private infrastructure owner where Aurizon Network proposes to modify its rail infrastructure and / or its operating rules in a way that may require changes to the private infrastructure or its capacity. Again, Anglo American does not understand Aurizon Network's reticence to have such important provisions covered in the Access Undertaking. Unfortunately, Anglo American can only conclude (as noted in its October 2013 submission on UT4):

The past behaviour of Aurizon Network in respect of key negotiations leads Anglo American to the view that it is absolutely essential that UT4 is prescriptive in nature, as any other approach will be open to allowing Aurizon Network to be opportunistic in the use of its monopolistic power not only for its own benefit but also its parent and related subsidiaries.

Further, in relation to removing clauses from the Access Undertaking and including them in commercially negotiated agreements, Anglo American reiterates its earlier submission that:

In essence, the QCA will be unable to monitor, investigate or intervene with any non-compliances, whereas under UT3 the QCA has the power to police these important protections. As coal producers and Aurizon Network have rarely been able to resolve difficulties or disputes by mutual agreement, Anglo American has no confidence that this approach will protect users in respect of these important matters.

11 Part 10: Reporting

11.1 General approach to reporting requirements

As Anglo American has already noted, as Aurizon Network is now a privately-owned enterprise (as opposed to a government-owned one at the time of the approval of UT3), it is vitally important to increase the reporting and auditing standards in order to ensure full transparency for the business. Unfortunately, Aurizon Network's UT4 submission has not reflected this need, but rather attempted to reduce the reporting and auditing requirements that it is required to undertake.

While Anglo American appreciates that Aurizon Network is now subject to a number of further reporting requirements due to its position in the Aurizon Network Holdings Group (eg, ASX), this does not impact on the need for full and frank reporting under the provisions of the Access Undertaking. Rather, Aurizon Network has drafted the reporting requirements in UT4 to give it

less restricting, less frequent, and fewer reporting requirements than it had under UT3. Anglo American does not agree with this approach.

Aurizon Network continues to protest its desire for transparency and reporting standards, including commenting that 'it has committed to the QRC working group to provide greater transparency and is currently reviewing a range of matters'.¹⁷ Anglo American trusts that Aurizon Network's redraft of the reporting and confidentiality requirements will ensure that UT4 reflects its commitment to transparency.

11.2 Confidentiality reporting

Anglo American is particularly concerned with Aurizon Network's response to stakeholders' comments that reporting regarding ringfencing compliance is too weak. In particular, Aurizon Network has refused to provide any further information on:

- (a) instances of breaches of confidentiality agreements;
- (b) complaint handling time and performance; or
- (c) errors in bills and the details of such errors.

Anglo American supports the comments previously made by stakeholders: as Aurizon Network is now a privately-owned enterprise, it is vital to have transparency and audit rights in order to ensure compliance with regulation and to provide regulatory certainty. Aurizon Network's reticence to provide information, even items as easily reported on as those noted above, does not breed confidence for the proper operation of UT4.

11.3 SUFA reporting

Anglo American notes that one of the key components of SUFA is that the SUFA agreements end when the SUFA-funded assets no longer have any value in the RAB. To facilitate transparency, Anglo American believes that 10.1.6 of UT4 should specifically require Aurizon Network to specify the value of each SUFA-funded asset in the RAB. This would reflect the amendments suggested by QRC to Schedule E.

In respect of the list of matters upon which the Auditor may be requested to audit under clause 10.8 of UT4, Anglo American would like to add 'discrimination between projects on the basis of obtaining an advantage for an Aurizon Network Associate including any related body corporate involved in providing services at a port or in respect of a railway which does not form part of the CQCEN.

11.4 Conclusion

As such, Anglo American fully supports all the drafting amendments proposed in the QRC First Submission. Anglo American does not support any of Aurizon Network's comments in the Aurizon Network Response to Stakeholders where it proposes not to make any change. Aurizon Network's current drafting of UT4 shows a weakening of ringfencing, auditing and compliance provisions coupled with decreased transparency and information flow for both industry and the QCA. Rather than strengthening the UT3 provisions to reflect the added transparency, Aurizon Network has weakened the protections on itself as a natural monopolist, along with creating opportunities to discriminate in favour of its related parties (that operate in competitive markets) without any way for the QCA or industry to review those actions. The QRC has made drafting amendments that rectify this issue and Anglo American strongly supports those amendments.

¹⁷ Aurizon Network Response to Stakeholders, 103.

12 Part 11: Dispute Resolution and Decision-making

12.1 Reduction in scope

Anglo American agrees with the submissions made by the QRC that the dispute resolution process requires significant amendments. Subsequently, Anglo American strongly supports all drafting amendments suggested by the QRC in its October 2013 submission on UT4.

In particular, Anglo American supports the QRC's concern that UT4 should not narrow the scope of the dispute resolution process and that it should be open to any party to refer all matters relating to the Access Undertaking to the QCA for determination. Anglo American submits that the possibility of QCA oversight and determination on all regulatory issues under the Access Undertaking is essential.

Anglo American does not believe that Aurizon Network has adequately addressed this point in its response to stakeholders. While Aurizon Network has agreed to reconsider the scope of Part 11, Anglo American cannot provide support for Aurizon Network's position until it has reviewed the drafting. Further, Anglo American will only provide support for Aurizon Network's redrafting in the instance that it accepts the QRC's position and enables the dispute resolution mechanisms to cover all aspects of the Access Undertaking. This also includes Aurizon Network's approach to the scope of parties that can lodge requests for dispute resolution. While a particular party may not be directly impacted by the immediate actions of Aurizon Network, because of the functioning of the CQCN and the Access Undertaking, a decision that that party is not involved in now, might yet affect that party later. As such, subject to QCA approval of a dispute request, the scope of parties that can lodge dispute requests should be extremely broad.

12.2 Precedence of the Access Undertaking process

Anglo American acknowledges that Aurizon Network is correct in pointing out that UT3 contained a provision (clause 10.1.1(b)) stating that the dispute resolution process in the Undertaking does not apply to Access Agreements unless otherwise agreed. The updated drafting of this clause for UT4 includes provision for a SUFA, split-form Access Agreement or other commercially negotiated agreement.

Anglo American does not agree that this clause should be maintained. Rather than giving rise to numerous potential dispute resolution mechanisms, Anglo American supports the QRC's suggestion that the UT4 dispute resolution process should take precedence. This could be subject to a carve-out for situations where a dispute arises from a clause that is otherwise inconsistent with the Access Undertaking (as Aurizon Network has raised as a concern in its response to stakeholders).

Aurizon Network has suggested that facts that give rise to a dispute under an Access Agreement (which can be otherwise negotiated by Aurizon Network) may also give rise to a non-compliance with the Access Undertaking. Anglo American does not believe that the right to utilise a transparent and regulated dispute resolution mechanism should be left to the mere possibility that the activities in question breach a provision of the Access Undertaking. Otherwise, Anglo American submits that the consistency and regularity of the Part 11 dispute resolution process is preferable to numerous variations under different agreements. This will provide certainty for users and financiers.

Anglo American strongly supports the argument of RTCA on this point, in particular that:

Aurizon Network has also reorganised a number of obligations that were covered under both the SAA and the undertaking. It is important that a number of these obligations can continue to be enforced by the QCA and not only through contractual or access disputes.¹⁸

12.3 Timeframe for resolution by mediation

Anglo American appreciates and understands Aurizon Network's suggestion that a timeframe of 5 Business Days may be too short to address some complex issues that arise under the dispute resolution process.

In saying that, Anglo American also notes the need for expeditious resolution of disputes. Where parties are simply unable to come to an agreed resolution (even with the assistance of mediation), Anglo American does not believe that it is beneficial for this to be subject to an open-ended timeframe that could stretch on for considerable periods of time. Rather, it is more appropriate for the mediation process to have a set timeframe that does not allow mediations to continue when it is unlikely that they will achieve a timely or cost-effective result.

Further, nothing in the QCA process prevents the parties from continuing negotiations or agreeing a resolution after a matter has been referred to the QCA for dispute resolution.

12.4 Conclusion

Unless otherwise notified, Anglo American supports the proposed drafting amendments in the QRC First Submission. As the existence of the natural monopoly inevitably causes a significant imbalance in bargaining and negotiating powers, Anglo American submits that it is essential for the dispute resolution process to have proper oversight and transparency for the regulator. Otherwise Aurizon Network's complete control of the rail element of the supply chain can go unchecked when attempting to negotiate or mediate a dispute.

13 Schedule E: Regulatory Asset Base

Anglo American generally agrees with the QRC First Submission in relation to the amendment of Schedule E of UT4. There are, however, a number of issues where Anglo American does not support the QRC's view.

In particular, Anglo American is concerned with the QRC's view that only the net proceeds of the disposal of assets should be deducted from the RAB. Anglo American disagrees with this position because the book value of the asset included in the regulatory asset base does not necessarily equal the value that Aurizon Network receives for an asset. As such, in situations where Aurizon Network receives significantly less than the book value of an asset once disposed, if the entire book value of an asset is not deducted from the RAB then Access Holders will continue to pay a WACC calculated on the remaining value of the RAB, including some aspect of that WACC giving Aurizon Network a reasonable return on the value of assets which it no longer holds, operates or maintains. While the objectives of UT4 include ensuring that Aurizon Network receives a reasonable return on the CQCN, it certainly does not include users paying a premium for assets no longer held by Aurizon Network.

Rather, Anglo American suggests drafting where the dollar value removed from the RAB is the book value of the asset as it currently appears in the RAB.

Anglo American believes that this prevents Aurizon Network from earning rent on assets that no longer form part of Aurizon Network's portfolio, as well as compensating for situations where Aurizon Network is able to achieve a greater return on assets disposed than the written down value of those assets.

¹⁸ RTCA First Submission, 11-12.

As such, Anglo American does not support Aurizon Network's drafting of UT4, or the proposed agreement of the QRC.

Further, Anglo American agrees with Aurizon Network's approach that the QCA should approve reasonable equity raising costs to be rolled into the RAB, however, submits that there should be a limitation on which equity raising costs can be included. Anglo American submits that only equity raising costs which are directly in relation to an action required under the Undertaking should be rolled into the RAB. Otherwise, users risk subsidising or fully funding equity raising activities for the benefit of the entire Aurizon Holdings Group. This breaches regulatory principles in numerous ways, however, Anglo American notes that if users are forced to subsidise equity raising costs that are subsequently applied to marketing, financing, or Aurizon backend operations, this could subsidise some of the costs incurred by Aurizon Operations and give an unfair advantage in the above rail haulage market.

14 Schedule G: Pricing for Blackwater Electric System

14.1 Background

Anglo American notes that while Aurizon Network has notionally withdrawn its 2013 Blackwater Electrical Traction Pricing Draft Amending Access Undertaking (**2013 AT₅ DAAU**), the submitted Schedule G to UT4 exactly replicates the proposed Schedule K under the 2013 AT₅ DAAU. As such, Anglo American wishes to reiterate its submissions made in June 2013 on the 2013 AT₅ DAAU, and also to make further comment the QCA Draft Decision on the 2013 AT₅ DAAU (released in November 2013), as similar reasoning assumedly now applies to the analysis of UT4 Schedule G.

Anglo American strongly opposes the approach that Aurizon Network has taken to AT₅ and fees for electric traction, both in the 2013 AT₅ DAAU and under UT4. As noted in its June 2013 submission, Anglo American has previously made submissions to the QCA regarding fixing (or increasing) the AT₅ tariff (see Anglo American's Submissions on the 2011 Electrical Traction Services Draft Amending Access Undertaking in April and November of 2012). Anglo American notes that Aurizon Network is again attempting to inappropriately force Blackwater diesel services to cross-subsidise electric services, and subsequently prejudicing competition in the above rail haulage market by driving preference toward contracting electric traction. Anglo American continues to oppose this approach.

14.2 Summary of Anglo American Submission on the 2013 AT₅ DAAU

In summary, Anglo American makes the following points regarding socialisation of electric traction pricing (for further detail please see the Anglo American June 2013 Submission):

(a) *Overreliance on cycle time*

In determining a lower Total Cost of Ownership (**TCO**), Aurizon Network relied on the fact that electric hauled trains have a lower cycle time. In determining this, Aurizon Network relied on extra CAPEX and OPEX attributed to diesel locomotives for provisioning and refuelling. In contrast, however, Anglo American notes that these activities are usually undertaken off-network in marshalling yards and have limited (if any) impact on cycle time. Further, electric traction efficiency is only properly realised when greater than 80% of the network operates that system; otherwise achieving faster cycle times for electric traction over diesel is purely hypothetical.

(b) *Aurizon Network made no consideration of current (or future) diesel technology*

In its comparison of diesel and electric traction, Aurizon Network based its comparison on electric and diesel train sets operated by Aurizon Network Operations. These diesel train sets do not operate using the more efficient electrically controlled pneumatic braking (ECPB) system and are

therefore not comparable to train sets utilised by other operators. For example, Pacific National has previously stated that its diesel train sets have close to identical sectional run times with electric operated trains. Further, Aurizon Network failed to consider any likely developments in technology, even though it seeks to fix AT₅ pricing over extended periods of time. As such, Aurizon Network's economic modelling relies on flawed assumptions that have not been adequately substantiated.

(c) *Hybridisation provides economic security*

Anglo American submits that a pure electric network is not economically secure, and as such Aurizon Network's attempt to incentivise coal producers to invest in electric traction rolling stock is inappropriate. A hybrid network is less vulnerable to sustain infrastructure outages, eg, an extended power failure. While high levels of rain and flooding can damage all systems, electrified systems are more vulnerable and diesel-powered locomotives can operate to recover lost capacity.

(d) *Socialisation of costs is inappropriate*

Anglo American submits that socialising the cost of network electrification is inappropriate. While some users utilise the electrified system, others still use diesel power. Diesel users should not be forced to cover an investment from which they receive no benefit. Particularly on the Blackwater System, users should not be required to pay a premium to support imprudent investments by Aurizon Network (especially where affected users were not provided enough information to cast an informed vote), or to support the electric network utilised by a completely different collection of users.

(e) *Anti-competitive impact on other operators*

As the CQCN is a natural monopoly, current regulation ensures that the market remains competitive and efficient. Currently, Pacific National remains the only true effective competitor that Aurizon Network Operations faces in the Queensland rail haulage market. While Pacific National might still be able to compete in the market, socialisation the cost of AT₅ will certainly impact upon its profit margin and, therefore, the economic viability of it operating trains on the Blackwater System (and, potentially, the CQCN). Even if Pacific National continues to compete, socialising the AT₅ cost will deter any smaller above rail operators from entering the market (as diesel is typically a safer mode of entry for new entrants as they can reach a wider range of customers). Aurizon Network's continued push for the socialisation of AT₅ (through the 2013 AT₅ DAAU, proposed Schedule G of UT4 and the redefinition of Reference Train Services on both the Blackwater and Goonyella Systems, discussed above in relation to Schedule F clauses 7.1(b)(iii) and 8.1(b)(iii)) raises serious questions about whether Aurizon Network's proposal is primarily to benefit its related operator (rather than on efficiency grounds), and whether the regulatory framework needs to be strengthened to prevent such behaviour. This is in clear contrast to Aurizon Network's clear attempts to weaken the regulatory regime, including ringfencing degradation and consideration of Aurizon Network's 'legitimate business interests'.

(f) *Changed risk profile and form of regulation without altering pricing parameters*

As recognised in the QCA's recently published pricing papers, the form of regulation impacts on the risk, and therefore, should logically impact on the return generated by regulated entities. The proposed Schedule G of UT4 effectively insulates Aurizon Network from its already small level of risk (such as the potential for optimisation of the electric traction infrastructure into the RAB where demand for its use decreases). Despite that reduction in risk, Aurizon Network proposes to leave its regulated rate of return unchanged under UT4, or even to increase the rate of return.

14.3 Points arising from QCA draft decision on 2013 AT₅ DAAU

Anglo American again notes that the 2013 AT₅ DAAU has been withdrawn, however, as the same proposal is made for Schedule G of UT4, Anglo American wishes to address some points arising from that draft decision which might also be relevant to consideration of Schedule G. Those points include:

The QCA indicated that it may be inclined to accept the Under-Utilisation Payment (**UUP**) if it is 'unlikely and immaterial'. The QCA suggested this would be the case where the 'volumes were set at a utilisation rate of around 65-70% of contracted volumes'. While this does give a lower threshold for users to meet, the objectives outlined in the QCA Act (ie, section 138(2)) that make the UUP inappropriate are equally applicable where the UUP applies a lower volume threshold. The major issue is that the UUP is unfair to diesel users and operators and does not promote efficient investment in the Blackwater System, rather than having anything to do with contracted or railed capacity. While a lower volume threshold might mean that the UUP is not activated every year, the risk it creates and the subsequent prejudice against diesel locomotives is not eliminated simply by changing the utilisation rate.

Anglo American particularly supports the QCA's finding that there is no efficiency advantage to using electric traction (contrary to the argument of Aurizon Network). The choice between electric and diesel traction is one best made by above-rail operators and their customers in a competitive market environment, and should not be prejudiced by the investments or subsequent fees and charges applied by the rail owner. Essentially, Aurizon Network's proposed Schedule G forces users to make a choice on the Blackwater System between electric traction services applied by Aurizon Network Operations or diesel services provided by Pacific National; this is a decision that Aurizon Network does not have the right to be involved in. Anglo American strongly supports the QCA's finding that if the proposed mechanism is applied as suggested by Aurizon Network it is likely to distort traction choice and create perverse investment incentives, both immediately and over the extended course of the Access Undertaking (even longer if the choice between electric and diesel traction is reinforced by 10 year Access Agreements).

As drafted, Anglo American notes that Schedule G of UT4 also incorporates the Rolleston Infrastructure. In the draft decision on the 2013 AT₅ DAAU, the QCA found that 'the Rolleston electrification assets should not be treated differently from any other assets on a single-user branch line'. Anglo American does not agree with this finding, and submits that the Rolleston assets should be specifically excluded from the operation of Schedule G. In particular, Anglo American submits that the Rolleston electrification does not pass the 'system test' as it is simply a single-user spur line and should not be rolled into the RAB.

Anglo American notes the similarity between the UUP mechanism suggested by Aurizon Network and the standard recovery mechanism under the Access Undertaking, however, points out that the UUP is being imposed on users that have no commercial contract to use the Blackwater Electric Network. As such, any socialisation (as found by the QCA) would 'have an adverse impact on competition in related markets, and interests of access holders, among others'. Further, Anglo American notes that diesel users are being forced to underwrite future investments, promoting over investment in electric infrastructure by users who do not require that service. Anglo American *might* support the UUP if, as suggested by the QCA, it truly is unlikely and immaterial, however, the UUP should still only be imposed on electric traction users as only they receive full benefit from electric investment. This should be accompanied by longer deferral of charges, and take-or-pay requirements in order to ensure that AT₅ operates in the same manner that the other building blocks do, and the cost of the AT₅ component is not subsequently borne through the ordinary recovery mechanism applied on the other building blocks. As such, Anglo American strongly submits that cross-system socialisation is not an option. Rather, Anglo

American supports the QCA's finding that where the costs of electric infrastructure will be borne by diesel users, the overall pricing can be expected to:

- (a) 'discriminate against diesel operators or their customer, without aiding efficiency;
- (b) discriminate in favour of Aurizon Network's related party, Aurizon Holdings, which predominately operates electric locomotives, while the third party (Pacific National) competes only with diesel locomotives in Blackwater and
- (c) erode above-rail competition by creating a perception that rules could be changed to favour the related-party operator, and therefore reduce productivity.'

As such, Anglo American supports the QCA's finding that socialisation of electric costs is inconsistent with the pricing principle in the QCA Act, and again reiterates that these factors operate even where the UUP is calculated on the basis of a lower utilisation rate.

While the QCA determined that the WACC should not be applied to compensate Aurizon Network for its asset stranding risk (as the QCA found this should be compensated separately), Anglo American strongly disagrees with this proposition. The QCA outlined that it has given Aurizon Network relatively high WACCs because it has wanted to promote investment in the CQCN, rather than to protect Aurizon Network against any asset stranding risks. Anglo American submits that contrary to these comments by the QCA, a regulated WACC is calculated by considering risk determining building blocks, and should encompass all the risk that Aurizon Network actually bares. As Anglo American has submitted numerous times, Aurizon Network bares almost zero risk on the CQCN, and should not double-recover when it makes an imprudent investment such as the Blackwater electric traction works.

As already considered, Anglo American agrees with the QCA finding that the UUP does not promote economic efficiency as it is outlined in Schedule G of UT4, because it is socialised across all users in the under-recover. This clearly discriminates against Pacific National and Pacific National users, and discourages any potential new entrants to the market wishing to apply diesel rolling stock.

The QCA took the view that the UUP will be within the legitimate business interests of Aurizon Network: Anglo American strongly questions the validity of that finding. The QCA has already determined that the UUP discriminates between users and is against the defined purposes of the QCA Act. As Aurizon Network is required to operate within the bounds of its applied regulation, until a UUP mechanism is proposed which fits within all criteria of the access test it is presumptuous to make a finding that any UUP (no matter the construction of the clause) will be in the legitimate business interests of Aurizon Network. As such, Anglo American does not support any finding that a UUP is in Aurizon Network's legitimate business interests.

Anglo American further supports the QCA's finding that Aurizon Network's 2013 AT₅ DAAU (and subsequently Schedule G of UT4) is not in the public interest because it does not promote competition in relevant markets. Anglo American notes that rather than promoting competition, the UUP truly operates to restrict competition. As such Schedule G of UT4 does not promote the development of the coal industry or further employment opportunities in Queensland, and is subsequently not in the public interest.

While Aurizon Network submitted that diesel users also get benefit from electric traction infrastructure, Anglo American does not agree with this argument. Whether or not diesel users are required to socialise the cost of AT₅, the only time when diesel users can actually accept this choice is at the conclusion of a haulage contract, meaning that any perceived selection benefit is only realised at the point of renewal. Further, all users have the choice between electric and diesel traction and this does not mean that users should be required to subsidise this choice. Rather than benefiting diesel users, the operation of the UUP and subsequently Schedule G

creates an unfair bias toward electric traction and may actually cause investments made by diesel operators to suffer the same stranding risk that Aurizon Network is supposedly protecting against. Further, socialisation of AT₅ through the UUP threatens to make users' investments uneconomic, and is essentially a penalty for users of diesel traction. No benefit Aurizon Network has outlined is sufficient to force one type of user to pay for infrastructure that only the other type of user actually requires. As such, Anglo American reiterates its submission that socialisation of the AT₅ component in the Blackwater System is completely inappropriate and Schedule G should be withdrawn.

SECTION 2: Additional issues arising from UT4

15 The Split Cost of Capital Concept

15.1 Concept

In its submission in relation to the QCA Pricing Papers in July 2013, Anglo American put forward support for a potential solution for the current lack of incentive for Aurizon Network to develop expansions in the rail network.

As the QCA is aware, the split cost of capital proposal provides for two separate WACCs as follows:

- (a) A WACC that reflects the current almost nil-risk activities undertaken by Aurizon Network for assets connect to the regulated entities Regulated Asset Base (**RAB**) that would attract a return close to the cost of debt; and
- (b) A separate WACC for expansion capital that reflects the higher risk (if any) associated with expansion activities to incentivise Aurizon Network's investors to undertake expansion activities.

15.2 Risk on the Regulated Asset Base

Anglo American fully supports the statement by the QCA that the WACC on the RAB should be connected to the regulated entity's guaranteed return. As the guarantee of return increases, the WACC on the RAB should consistently approach the cost of debt.¹⁹

In Aurizon Network's case, the guarantee of the return on the RAB on the CQCN under UT3 is almost certain. This can be seen from the following factors:

- (a) UT3 is 100% take or pay for a number of the elements of the tariff (AT_{2, 3} and 4);²⁰
- (b) UT3 provides for the payment of relinquishment fees where access rights are to be relinquished or transferred;²¹
- (c) UT3 includes a revenue cap and an annual process for resetting volume forecasts, to reduce the size of revenue cap unders/overs and therefore reduce cashflow timing differences;²²
- (d) UT3 allows accelerated depreciation of rolling 20 year asset lives for some capex;
- (e) Aurizon Network is able to lodge draft amending access undertakings (**DAAUs**) and seek adjustments when risks are realised, or when the likelihood of realisation is perceived to increase. Examples of this include the DAAU for maintenance cost adjustments during UT2 and the Electric Traction DAAU during UT3. Customers do not have a similar right to seek adjustments using DAAUs;²³ and
- (f) Aurizon Network is able to achieve additional risk transfer through the use of agreements with customers for which standard (regulator-approved) agreements do not exist. These include (as examples) agreements for:
 - (i) the funding of studies such as feasibility studies;

¹⁹ Queensland Competition Authority, *Discussion Paper: Split Cost of Capital* (2013) vii.

²⁰ Aurizon Network's 2010 Access Undertaking, Schedule F, Part B, clause 2.2.

²¹ Aurizon Network's 2010 Access Undertaking, clause 7.3.6.

²² Aurizon Network's 2010 Access Undertaking, Schedule F, Part B, clause 3.

²³ See schedule 1.

- (ii) transfer facility licences;
- (iii) relocation deeds;
- (iv) level crossings;
- (v) RIM and train control services on customer specific spurs; and
- (vi) funding of customer specific spurs.

Under UT4 these protections remain and, in fact, there are further protections, including reducing the circumstances in which the RAB can be optimised by the QCA.

The only risk that a regulated entity faces on its RAB is generally a regulatory one. This might include changes to how the regulator operates or how the regulator determines Reference Tariffs for the RAB. The risk might also include the regulator's approval of opex, maintenance or force majeure reimbursement. In Aurizon Network's situation, Anglo American submits that this regulatory risk is particularly low.

In the above circumstances, Anglo American agrees that the RAB should earn at or just above the cost of debt.

Anglo American has prepared a submission in relation to the QCAs various papers on calculating the WACC and in response to issues discussed at the WACC forum on December 2013 and will provide this submission separately.

15.3 WACC on expansion capital

While Anglo American understands that the WACC attributed to new or expansion infrastructure under the split cost of capital concept will generally be higher than that applied to existing infrastructure, Anglo American also believes that this is not a 'rule' which applies to each expansion. There are some expansions where risks are low and some where the risks are higher. Even if the expansion WACC is an average WACC, this fundamental principle needs to be kept in mind.

Anglo American submits that it is incorrect to attribute the phrases 'high/higher WACC' and 'low/lower WACC' to the multiple WACCs created by a split cost of capital system. What should actually be created are 'separate WACCs' which reflect the risk borne by the regulated entity on that particular infrastructure asset. In the case of Aurizon Network, that could mean different systems, different networks or the existing CQCN as opposed to expansion works.

The WACC on expansion capital does not apply to reward the regulated entity for making the investment, but rather to compensate and insure the regulated entity for the increased risk that it adopts because of its increased capital in that new or expansion infrastructure. As such, the WACC applied to the new or expansion infrastructure directly correlates to the risk adopted by the regulated entity and does not simply apply because there has been an investment.

For example, if Aurizon Network were to invest in a passing loop on the existing CQCN, if we apply the split cost of capital concept this should not necessarily attract a 'higher' WACC. Aurizon Network is strongly protected by the existing customer base on the CQCN because in making the investment it has 100% Take or Pay contracts, opex and maintenance modifiers and virtual insurance by users. As such, the increased risk accepted by Aurizon Network through this type of expansion work is little to none, and should not necessarily attract a WACC any higher than already exists on the CQCN, even if the QCA is to apply the split cost of capital concept and determine an alternate WACC.

Further, if Aurizon Network were to complete a major augmentation of the network (for example, a system similar to GAPE even this might not attract a significantly 'higher' WACC in light of protections contained in UT4, including:

- (a) the revenue cap form of regulation;
- (b) 100% Take or Pay contracts with users;
- (c) accelerated depreciation (although Anglo American disagrees with the approach adopted by Aurizon Network); and
- (d) the process for customer pre-approval for the scope of capex and procurement strategy, which reduces the risk of capex / costs not being included in the RAB.

As such, Anglo American supports the proposal of a split cost of capital in the form of separate WACCs, one for each independent system which will be matched to the risk for each type of activity.

15.4 Risks in respect of opex

In the Split Cost Paper, the QCA also considers the various situations that a regulated firm could be in and the risk associated with those activities. One cost that is considered is the opex and maintenance costs associated with maintaining serviceable infrastructure: in the Split Cost Paper the QCA considers that operation of infrastructure creates a moderate level of equity risk.²⁴

Anglo American disagrees with this analysis for all regulated entities, in particular with reference to the opex and maintenance costs accepted by Aurizon Network. Through the AT₁ charge, Aurizon Network recovers its exact cost of maintenance every year, determined *ex post* rather than *ex ante* so that reimbursement precisely reflects disbursement. Although it might be argued that this charge represents a certain element of risk, as long as Aurizon Network's outgoings are prudently incurred its maintenance charges cannot be rejected.

Similarly, UT4 contains a number of cost pass through provisions in respect of opex costs.

15.5 Criticisms of the split cost of capital concept

The split cost of capital concept has received some criticism. Anglo American notes that DBCT Management expressed concerns that the split cost of capital proposal:

... 'may not fully recognise investor expectations and may be based on a number of flawed assumptions regarding risks attached to the RAB'.²⁵

Anglo American assumes that Aurizon Network would express the same concerns regarding not recognising investor expectations, specifically since the float of Aurizon Network (as QR Network in 2010). Anglo American also understands that similar concerns were also raised by critics of Professor Dieter Helm's papers in the United Kingdom.²⁶

In response to this concern, Anglo American submits that regulatory risk is or was fully anticipated by investors, and properly outlined by Aurizon Network in its Prospectus during its float. Changes to the model of regulation, in this instance applying the split cost of capital concept, are part of the operation of a regulated entity and stunting or restricting regulatory growth and development does not achieve the purpose of regulating an entity. Anglo American submits that regulation should evolve to meet the needs of the industry and the regulated entity itself, and should not be avoided merely because it affects the return to investors.

In Aurizon Network's case, investors were fully informed of the regulatory risks associated with investing in Aurizon Network from the time of the float. In particular, investors were fully informed

²⁴ Queensland Competition Authority, *Discussion Paper: Split Cost of Capital* (2013) 4, in particular see Table 2.1.

²⁵ Dalrymple Bay Coal Terminal Management, *Submission to the QCA Split Cost of Capital Discussion Paper* (31 July 2013)

²⁶ Queensland Competition Authority, *Discussion Paper: Split Cost of Capital Concept* (2013) 20.

that regulation of the assets could change with time and negotiation between the parties. The QR National share prospectus included the following discussion of regulatory risk:

'QR National's network is subject to extensive regulation that significantly affects its business, and there is a risk of regulatory outcomes that are adverse to QR National'.²⁷

Investors made informed decisions to invest in Aurizon Network knowing that regulatory risk existed and changes to the regulatory approach over time could be expected. Anglo American does not believe that this is an adequate excuse to avoid any kind of regulatory change or adaptive pricing techniques applied by the QCA. Furthermore, Anglo American does not believe this is an adequate reason to reject the split cost of capital concept.

At this point in time, there is no evidence to suggest that applying a split cost of capital mechanism to Aurizon Network's regulated assets will decrease its overall average level of profits. On the contrary, prudently-made and operated expansions should attract an ultimate WACC which rewards Aurizon Network for participating in the growth of the industry, at the same time as it is compensated for extra risk accepted and positive involvement in developing the coal network, provided that the WACC on the existing asset base truly reflects the risks associated with that asset base and the case for a higher WACC, if any, is made out for and reflecting the risk of any expansions.

15.6 Timing for the alternate WACC

A very difficult issue is whether the alternate WACC applies only during construction and then the RAB WACC applies after the asset has rolled into the RAB.

Whilst theoretically Anglo American agrees with the findings of the QCA on the timing for applying an alternate WACC on expansion assets, it is concerned that this may not be sufficient to provide an incentive for Aurizon Network to undertake investments in a timely manner.

This might mean that the QCA applies the alternate WACC for a period of 2 to 3 years after completion of the expansion project in order to adequately compensate Aurizon Network for any greater risks taken.

An alternative which might apply where Aurizon Network has undertaken an expansion which is not fully underpinned by 100% Take-Or-Pay contracts, then the alternative WACC could also operate with a percentage-based limit of capacity; for example, Aurizon Network would receive the alternate WACC for 2 years or until it reached 90% capacity run rate, whichever came first.

15.7 Issues which might undermine split cost of capital

Anglo American understands that, for the rail industry in particular, this is a time of regulatory change.

Of particular concern to Anglo American, in its UT4 submissions Aurizon Network has removed the access conditions regime so that users can no longer force Aurizon Network to invest in expansions or new infrastructure. If the QCA approves the split cost of capital concept to apply to Aurizon Network's regulated assets and yet there is no access conditions regime, the QCA has achieved no development in the regulation of Aurizon Network. While the QCA might determine an alternate WACC which rewards Aurizon Network if it invests, this does not necessarily change Aurizon Network's behaviour to expansions and it may continue to refuse to invest, even at the alternate WACC. This would perpetuate the incentive for 'economic hold-up' and not provide the incentive that is required for the revenue cap to operate effectively.

²⁷ Queensland Rail National, *Share Prospectus* (2010) 21.

Anglo American fears that if the QCA approves the removal of the forced investment regime in UT4, it will only provide a reinforcement for Aurizon Network's aggressive pricing approach to expansions. Rather than creating a cap on the Reference Tariffs that can be charged on expansions, the QCA-determined alternate WACC will provide a fallback position which Aurizon Network knows that it can receive if it invests under regulation. This does not mean that Aurizon Network will not refuse to invest under regulation and rather force commercial negotiations which result in imprudent and economically unfeasible outcomes for users with WACCs well above the ceiling set by the QCA as the alternate WACC (similar to the commercially negotiated outcomes achieved in GAPE and WIRP).

While Anglo American fully supports the split cost of capital concept, without a forced investment structure in the Access Undertaking applying to the regulated entity, the split cost of capital concept is almost completely and utterly useless. As such, the split cost of capital concept cannot be considered separately from the form of regulation or the principles applying under that form of regulation and these form essential elements as to the appropriateness and effectiveness of the split cost of capital concept.

16 Determining the WACC

Anglo American submits that the WACC suggested by Aurizon Network is far too high in light of the very low risks faced by Aurizon Network under UT4.

Anglo American supports the view of the QCA in its Statement of Regulatory Principles 2013 that the form of regulation and the ancilliary mechanisms of risk reduction are relevant to the WACC parameters, in particular, the beta.²⁸ Anglo American also supports the submissions of the QRC and its experts in respect of the WACC parameter, with the exception of beta.

Further discussion in relation to the calculation of the beta and the other methodologies in calculating the WACC are outlined in Anglo American's separate WACC submission.

²⁸ Queensland Competition Authority, *Statement of Regulatory Pricing Principles* (August 2013) 17, 33-34.

Schedule 1: Anglo American proposed drafting of Part6, Part 7 and Schedule H

Please see attached.

Schedule 2: Anglo American's proposed drafting of Part 8

Please see attached.

Schedule 3: Explanatory Notes on Network Management Principles

Please see attached.