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Issues and Concerns with Aurizon Network's (AN's) 2013 Draft Amending Undertaking (DAU)

1. Key Messages

DAU	BMA and BMC Position
Pricing	• WACC should reduce from 9.96% to 5.65% based on regulatory precedents • Cost control and productivity is critical • Productivity improvements must offset rising costs • Regulated tariff share of corporate costs should also be reducing (as per Investor Briefing, dated 18 July 2013)
Capacity Management	• Reinstate $300M investment obligation on AN • Workable SUFA process for projects greater than $300M (as per QRC's SUFA submission) • Industry to have the discretion to develop its own mine and logistics growth pipeline through a clear and transparent Expansion Process
Form of Regulation	• All assets in the regulatory asset base to be included in the regulatory pricing framework, including all connection infrastructure to the CQCN • Reform revenue cap mechanisms to reflect annual pricing, no regulatory smoothing and revenue true-up soon after the end of the year • Keep variable costs variable
Transparency, Performance & Reporting	• Maintenance scopes to be fully documented, consulted on, approved, and reported on in terms of performance to plan • Symmetrical risk/reward financial incentives to promote performance to contract
Other	• Challenge necessity of 100% rewrite as it has not simplified this regulatory process • DAU is being used to water down UT3 regulatory protections • Blurs distinction between regulation and commercial negotiation • Lack of reconciliation between actual expenditure and forecasts in the instances where AN claims that external benchmarks are not relevant to AN • Challenge the commitment of AN to an open informed analysis of its proposed approach given the lack of forewarning prior to the publication of the DAU when it is clear it has been developing the submission since at least early 2012 (based on timing of expert reports), identification of changes to the modelling approach, awareness of error in the corporate overheads cost build up in UT3 and the decision not to invest in the ballast consist as planned and funded in UT3

2. Supply Chain Partnership

The DAU does not provide for the commercial alignment of interests between producers, rail operators and AN. We recommend the Authority adopt the following guiding principles to assess the merits of the DAU.

- Maximised coal throughput from enhanced performance of the existing asset base and expanding the network in a timely and efficient manner.
- Effective planning process which stages expansion projects, from concept through to execution, to ensure scope, standard and cost is efficient and optimal.
- Reliable delivery and security of supply on all AN's contractual commitments.
- Transparency on scope of work and performance accountability on AN's asset management, maintenance and system wide and regional cost base.

- AN and industry collaboration on operating costs, capacity and capital trade-offs, with agreed scope reimbursed at efficient cost through coal reference tariffs.

- Responsiveness to coal market cycles.

- WACC on existing Asset Base to be assessed by QCA – providing an appropriate return for risks borne.

- SUFA to be commercially viable as a third party funding vehicle with mechanisms to ensure scope, standards and costs are efficient and to provide industry with an unfettered expansion pathway.

- Symmetrical incentive framework to align AN and industry's performance metrics.

- Flexible transfers of capacity where AN is not financially disadvantaged.

3. Competitiveness of the Queensland Coal Industry

In the last twelve months, the Queensland coal industry has experienced a very challenging environment due to a combination of the high Australian dollar and lower metallurgical and thermal coal prices. In the past 18 months we have significantly reformed our coal operations to reduce costs and increase productivity to ensure we remain globally competitive. Despite these efforts there has been a significant escalation in rail infrastructure costs over the last four years.

The DAU is out of step with efforts to ensure conditions for Queensland's coal industry are globally competitive. In not constraining its existing cost base and in demanding above regulatory returns for any new capital, AN is directly impacting on our business by increasing both the cost of rail infrastructure upgrades and the ongoing cost of transporting coal from mine to port. The DAU must enable critical monopoly rail infrastructure to be efficiently costed, managed and expanded.

4. Pricing Principles

We support the fundamental principle that existing customers must not bear any of the commercial risks and costs associated with major expansions of the network, which if included in the existing pricing of the Coal System would result in the reference tariff increasing for all existing customers. Existing, non expanding customers should not incur any additional costs from an expansion where they:

- do not receive any benefit by way of increased contracted tonnage throughput;

- are not involved in the negotiation of the expansion project or given access to the commercial information underpinning the expansion.

In addition, any financing, credit and default risk of the counterparties in any major expansion which attracts a premium should not be passed on to existing customers in the event that any of the risks materialise within the first 10 years of the project.

Implementation of the these pricing principles will ensure that new and expanding customers (willing to conclude a commercial project investment agreement with AN or fund through a SUFA transaction) are not unnecessarily delayed or prevented from executing commercial agreements by existing, non-expanding customers who might otherwise be minded to consider their own commercial business exposure in any such transaction. This will ensure efficient investment decisions are made by both AN and expanding customers given they are bearing the full cost of the capacity being installed.

5. Major Project Expansion Process

The DAU Expansion Process lacks clarity, transparency and accountability. It imposes AN as the “judge and executioner” on Central Queensland coal projects by allowing AN to determine which producers are included in an expansion feasibility study, the scope of studies delivered and the commercial arrangements to be offered. Given industry is required to fund any feasibility studies beyond concept studies, this level of interference and lack of engagement is unacceptable.

It is imperative that amendments to the DAU’s Expansion Process be implemented as a priority. If this is combined with the QRC’s proposed amendments to AN’s SUFA submission (currently being considered by the Authority) then we believe industry will have the ability to trigger rail infrastructure expansions consistent with its mine growth pipeline. This will provide an alternative viable investment framework and will mitigate against AN’s monopoly position in the Queensland rail infrastructure market.

6. Removal of $300 million Voluntary Funding Obligation

The removal of a voluntary undertaking to invest in new capital up to $300 million in its network will constrain smaller scale industry growth due to the lack of a suitable funding framework for investments below $300 million[1]. AN has compounded this outcome further by removing any ability of the Authority to have oversight of any access conditions AN may require in order to invest in a small capital project. This outcome is not sustainable given the declining competitiveness of the Australian coal industry when compared with its competitors in other countries.

7. Regulatory Modelling Approach Front Ends AN’s Revenue

In the DAU AN adopts a clinical review of every revenue parameter and optimises each parameter in AN’s favour, resulting in an upwardly biased annual regulatory revenue stream, by:

1. Adopting a uniform 25 year asset life for all assets in the Regulatory Asset Base which is at odds with the economic life of the coal industry in Central Queensland[2].

2. Reducing AT1 while noting that it is using significantly more third party inputs to undertake the maintenance task, thus increasing the variable portion of the maintenance budget and justifying major cost increases on the basis of higher throughput.

3. Adopting the AER’s post tax revenue model which removes the half WACC adjustment to Aurizon’s cash flows and removes the need for a working capital allowance. This creates an uplift in Aurizon’s annual revenue because the previously approved working capital allowance was less than the benefit AN receives by changing the modelling approach. AN’s rationale for the change is to ‘facilitate the ease of use and understanding of the model and reduce the risk of error’[3]. Given these benefits accrue primarily to Aurizon it is unclear why Aurizon should be provided with a revenue uplift to facilitate them.

4. Changes to the approach used in UT3 for developing maintenance costs, including:
   - An ROA charge based on the modern replacement value of the maintenance equipment used without clear specification of how factors such as equipment maintenance costs and reliability forecasts have been adjusted to take into account this change;

[1] AN has advised BMA that the suite of SUFA is not workable on smaller scale projects. AN has also advised that for smaller investments the only available funding framework requires grossing up a project’s capital cost to include AN’s 30% tax liability generated by the transaction. Such a gross up effectively provides AN with the opportunity to extract monopoly rent in the provision of commercial terms for these projects by keeping any increase below the 30% gross up amount.

[2] BMA’s Life of Asset plans extend to beyond 2070

[3] Page 193, Volume 3

- A corporate overhead charge based on a bottoms up build-up of the corporate costs of a company of a similar size that delivers similar services without providing evidence that these costs are not included in the System-wide and Regional cost build up;
- Major investment in ballast cleaning consists which will be required for the long term maintenance of the network but is not included in the Regulatory Asset Base. If these assets are (as is suggested by AN) essential to the maintenance of the network their ownership by AN places AN in a very strong competitive position relative to an alternative supplier of this service and leaves CQCN users at risk that in future regulatory periods the related Aurizon company may substantially increase the ROA on these assets; and
- The related Aurizon company charges CQCN users 100% utilisation of CQCN track machine assets minus any actual savings incurred from Aurizon's use of the assets in areas outside CQCN. This, combined with the AN's lack of accountability on scope, means AN could be incentivised to maximise non-CQCN work at the expense of maintaining the CQCN.

Further detail on maintenance costs is provided below.

5. Adopting a cost-allocative approach to Aurizon's existing expenditure based on actual costs and proportions which do not reflect the efficient stand-alone costs of a provider of access services in central Queensland. This approach involves:
    - proposing a System Wide and Regional Cost allowance of $123.6M in FY14 which is a 103% increase in operating costs over the average UT3 annual allowance of $60.1M;
    - proposing operating costs increase which are disproportional to the increase in tonnages in UT4;
    - claiming loss in economies of scale from its separation from Queensland Rail when in previous regulatory processes, AN argued the complexity of managing the Queensland Rail business required more complex operational structures;
    - providing independent benchmarking studies which detailed a very limited sample of companies on a confidential basis such that it is not clear whether they can be regarded as a relevant comparator;
    - providing no reference to the publicly available ARTC Hunter Valley Coal cost structure which is a relevant comparator and appears to operate with significantly lower operating costs.

    Further detail on operating costs is provided below.

6. Changes to UT3 electric traction connection and supply costs including:
    - Electricity connection costs in FY14 are forecast to be $68.3 million are a 107% increase from the $33 million cost incurred in the first year of UT3;
    - This cost increase is a concerning trend for industry and ultimately may impact on the relative economics of diesel versus electric traction options in the Blackwater and Goonyella rail systems;
    - It was also not anticipated by AN when it submitted its Draft Amending Access Undertaking on proposed upgrades to the Blackwater system;
    - It raises concerns about the ability of Aurizon to accurately forecast the true cost of running the electric system;
    - AN's electricity supply costs includes a pass through of environmental charges including the Queensland Gas Scheme and the Enhanced Renewal Energy Target Scheme. The forecast UT4 environmental charges increase from $4.6M in FY14 to $6.6M in FY17. Rather than add these costs to the EC component of tariffs, AN seeks to argue these costs are a "defacto" tax and should be included as an overhead cost and paid by both electric and diesel traction users;
    - We do not agree that electricity environmental charges should be included in general overhead costs but rather it should be part of the EC tariff component;

- Whilst it only represents a couple of cents per tonne, we are of the view that these costs should be quarantined to electric traction users and be part of the EC charge (and not simply socialised arbitrary adjustments) so as to not distort efficient and market decisions around traction choice. The fact is that environmental charges have not been levied on diesel fuel and so should not be paid by diesel traction users in the CQCN;
- The Authority must assess that these costs are being passed through at cost. We would also like AN to pursue more cost efficient supply options and would like greater transparency and consultation on supply and connection arrangements being contemplated; and
- We support AN's Regenerative Braking Proposal.

7. Proposing a combination of external insurance, self-insurance and regulatory pass-through provisions to manage risks to network infrastructure. We have several concerns with the risk and insurance submission including:
   - There is still significant uncertainty regarding the coverage and nature of AN's self-insurance program. For example, does it reflect an efficient and prudent level when the forecast maintenance, capital expenditure and historical incident rates are taken into account?
   - There is an apparent failure to be able to claim on an insured risk relating to repairs to a declared bridge damaged in the 2013 Central Queensland flood event;
   - AN holds a position of conflict, which enables it to "bundle" losses and to determine the repair scope, so that the $1M threshold can always be exceeded;
   - The "blurring" of costs between self-insurance claims and maintenance cost allowances and opportunities for "double recovery";
   - We note from the Willis Report, that the largest asset class covered in the Industrial Special Risk policy is Feeder Stations, which are valued at $560M. We request the Authority give consideration to including the share of the Industrial Special Risk premium for Feeder Station insurance in the AT5 component of access tariffs; and
   - Risk and Insurance costs have risen substantially in UT4. The Authority should assess the appropriateness and efficiency of Aurizon's self-insurance and external insurance program and its relationship to forecast maintenance and capital programs.

8. Providing minimal detail on how AN has adjusted its revenue requirements to reflect revenue from the non-coal traffic on its network.

9. Not providing a CPI-X efficiency measure in its operating or maintenance costs forecasts. Where CPI or MCI indexation allows prices to increase in line with the rate of inflation, X factor adjustments provide for a real price adjustment to capture efficiency gains to be expected over the regulatory period. The objective of a CPI-X price adjustment in regulated industries is to ensure a regulated business prices its outputs as it would in a competitive market. A CPI-X efficiency measure was applied by the Authority in UT1 and UT2.
   - In UT3 the Authority accepted AN's request for the X factor be valued at zero on the basis that sufficient productivity improvements had already been incorporated into AN's UT3 estimated maintenance and operating cost forecasts. The UT3 forecasts were fully transparent to the Authority and outlined a "bottom up" analysis of the expected costs to be incurred that included specific efficiency improvement measures. In contrast the UT4 documentation has not outlined similar explicit efficiency gains that have been imbedded into the UT4 maintenance cost forecasts.

   We are concerned the DAU does not address a CPI-X efficiency measure as an issue requiring an Authority decision. Whilst the Authority is presented with the overwhelming task of sifting through all cost data (based on a cost allocation within Aurizon's Management Accounts), external reports and confidential reports within a relatively short period of time, we need to ensure the standard regulatory efficiency measure is not forgotten in the midst of this review activity. Where any doubt exists in the Authority's mind with respect to a decision on AN's forecast regulatory cost base, then we recommend the Authority also apply an X factor adjustment to provide sufficient incentive for AN to deliver efficiency savings over the UT4 period.

8. Maintenance Costs

The DAU's FY14 maintenance cost estimates are significantly higher than any maintenance costs previously approved by Authority:

- 20%+ higher in real terms than the FY13 budget approved by the QCA in UT3; and
- 25% higher in real terms than the FY14 interim tariffs approved by the Authority in May 2013.

This now introduces an additional commercial risk for our business in FY14 and reinforces the belief that AN is interested only in revenue protection as a base position and significant revenue uplift as its principal aim. This approach conflicts with industry's stated request that AN review the efficiency of existing revenue streams, seek cost mitigation measures wherever possible and reflect cost deflation given the easing of cost pressures in central Queensland.

We are concerned about whether AN is managing its FY14 budget to the Authority's approved FY14 interim tariffs revenue stream. We will be extremely disappointed if, despite industry's best efforts to develop a negotiated FY14 interim tariff, we learn that AN has continued to spend its maintenance budget based on the DAU's FY14 maintenance cost forecast. In the event this has occurred, we request the Authority carefully sift through AN's FY14 maintenance expenditure and ensure all expenditure was necessary, prudently scoped, efficiently delivered and appropriately priced. The Authority must be vigilant to ensure AN does not use its FY14 actual expenditure to become a self-fulfilling prophesy for the 2013 DAU maintenance allowance.
We note that this is the second successive regulatory period where AN has proposed a very significant increases to its maintenance allowance. We believe the size of the cost increase is excessive given our expectation that coal volumes will be lower than the forecasts that formed the basis of the 2010 DAU and the easing of cost pressures in Central Queensland. We have for following concerns with AN's approach:

- The use of modern equivalent asset values creates significant complexities with respect to the estimation of the maintenance costs of new machines (relative to the existing fleet) and this needs to be taken into account;
- The potential for double counting corporate overhead costs not excluded them from AN's cost build up;
- The opaque nature of the cost build up approach where AN has stated that there are specific characteristics of its network such as ballast contamination and the electric overhead that make it difficult to find comparable benchmarks;
- The major investment in the ballast cleaning consist given similar investment was forecast (and budgeted for) in UT3, but not delivered. This raises concerns for us about the real possibility they will not be delivered in UT4. Can the Authority provide some regulatory protections where industry pre-pays major investment projects which are subsequently not delivered?
- The lack of (or no) allowance or acknowledgement for the non-delivery of AN's maintenance scope during UT3 (e.g. ballast undercutting, resurfacing, re-railing) in the 2013 DAU cost build up or discussion

This final point is significant because AN should have anticipated that this would be an issue that would be raised by industry, particularly given the proposed UT3 investment in the ballast wagons had a material effect on the UT3 maintenance budget. We understand changes to investment strategies and maintenance budgets would be expected in a four year maintenance plan which has been detailed twelve months before the beginning of the regulatory period.

We understand that it might be an Aurizon Board (not AN Board) decision on whether or not to invest in ballast cleaning consists. If this is the case, then we request the Authority obtain an undertaking from Aurizon that it will be approving the investment during the UT4 period. Alternatively, the Authority could include regulatory protections in UT4 to ensure that where a proposed investment does not occur then a proportionate reduction can be made to AN's maintenance budget.

We recommend the Authority review the DAU on the basis of the established regulatory principles of:

- Prudency of Scope - we support the principle that AN's proposed scope of maintenance work be sufficient to maintain the CQCN rail infrastructure to a standard consistent with good railway operating practice so reliably and safely delivers services at approved coal volumes throughout UT4.

- Efficient Costs - we support the principle that AN's maintenance expenditure be assessed on an efficient cost base that will effectively deliver the required maintenance scope.

- Standalone Cost Basis - we support the established use of a hypothetical standalone coal network business to reflect the efficient cost of maintenance services on the coal network.

- Transparency of Reporting – we support a much greater degree of transparency and level of maintenance reporting than has previously been undertaken by AN. Previous regulatory reviews effectively examined AN's proposed maintenance scope and budget costs at the commencement of the regulatory period. However, once approved by the Authority, it appears that AN simply re-arranges its maintenance activities to fit within the approved budget and is not in incentivised to improve efficiency of cost to deliver the approved scope of services within a smaller budget. We recommend AN provides industry with annual information that details how it is delivering its proposed maintenance plan and how it is monitoring and improving the efficiency of the delivery of maintenance services.

9. Operating Costs

The DAU proposes a System Wide and Regional Cost allowance of $123.6M in FY14, which is a 103% increase over the average UT3 annual allowance of $60.1M. This represents yet another step increase in previously approved System Wide and Regional Cost allowances given that there was, on average a 130% increase in the average annual UT2 allowance. Given the total forecast volume in UT4 (i.e. from FY14 to FY18) is 910Mt and only an 8% increase in UT3 forecast volumes of 841Mt. The proposed operating cost increase appears disproportional to the increase in tonnages, notwithstanding that much of System Wide and Regional Cost structures are relatively fixed.

AN justifies the cost increases by noting that the separation of Queensland Rail from Aurizon reduced the economies of scale of AN's operations, the significant increases in volumes on the network, an error in the way in which corporate overheads were calculated in UT3 and a benchmarking exercise conducted by Ernst and Young. Each of these rationalisations is concerning because:

- The UT3 operating cost budget was set based on the QCA's assessment of the standalone costs of the coal network and the implication of the loss of economies of scale argument is that the non-coal businesses was effectively cross subsidising the coal business. No specific examples of how this occurred or the veracity of the claim has been provided.

- The increase in volumes on the network is significantly less than the proposed increase in system wide and regional costs and it would be expected that many of these functions would be capable of dealing with extra throughput without significant cost increases. For example, system planning requires the development of a complex model to estimate system capacity but the marginal cost of adding additional trains / mines / ports to this model would be relatively small relative to the cost of the original model build.

- AN has adopted a rigorous user pays approach to expansions and customer specific projects. This user pays approach would be expected to reduce the incremental cost burden of any customer specific expansions.

- AN states the corporate overhead allowance in UT3 was understated because "corporate costs that were previously accounted for and contained in business units costs are now transparently recorded in corporate service areas"[4]. If this was the case, then it would be expected that there would be a commensurate reduction in the costs of the areas where the costs were previously allocated to. No evidence that this is the case is presented by AN. Moreover, simply the reallocation of costs from one cost centre to another cost centre does not then justify the increase in the total budget.

- The benchmarking exercise presented by AN is based on a very limited sample of companies which are all presented on a confidential basis. It makes no reference to the publicly available ARTC Hunter Valley Coal cost structure which is a relevant comparator and appears to operate with a significantly lower operating cost.

AN's DAU operating expenditure submission should be reviewed on the basis of the established regulatory principles of:

(a) Efficient Costs - we support the principle that AN's operating expenditure should be assessed on an efficient cost base that will effectively deliver contracted access services. The use of benchmarking is considered an appropriate means of identifying efficient costs provided that the benchmark organisation is an appropriate and demonstrably efficient comparison.

(b) Standalone Cost Basis – AN's regulatory business is a self-contained as well as geographically concentrated and coal centric business. This can be directly contrasted with Aurizon's contestable, geographically diverse and multi-commodity, above rail business. In assessing the standalone costs of AN, the relative simplicity of the CQCN business compared to the related above rail business, needs to be taken into account.

(c) Appropriate Allocation of Overhead/Support Costs - Aurizon is a vertically integrated above and below rail business, with its above rail business competing with third party rail operators on the CQCN. With a large portion of operating costs allocated to AN from overhead/support functions there is a potential for costs not reasonably attributable to the provision of access services on the CQCN to flow to the below rail business. If these overhead/support costs are inappropriately allocated to the below rail business in favour of the above rail business, this could materially discriminate against third party rail operators and would hinder effective competition.

(d) Transparency of Reporting – we support a greater degree of transparency and consultation on the operating arrangements and expenditure contained in UT4, compared to previous access undertakings. This includes consultation on electrical transmission connection agreements which will be renegotiated during UT4 and transparency with insurance and risk arrangements.

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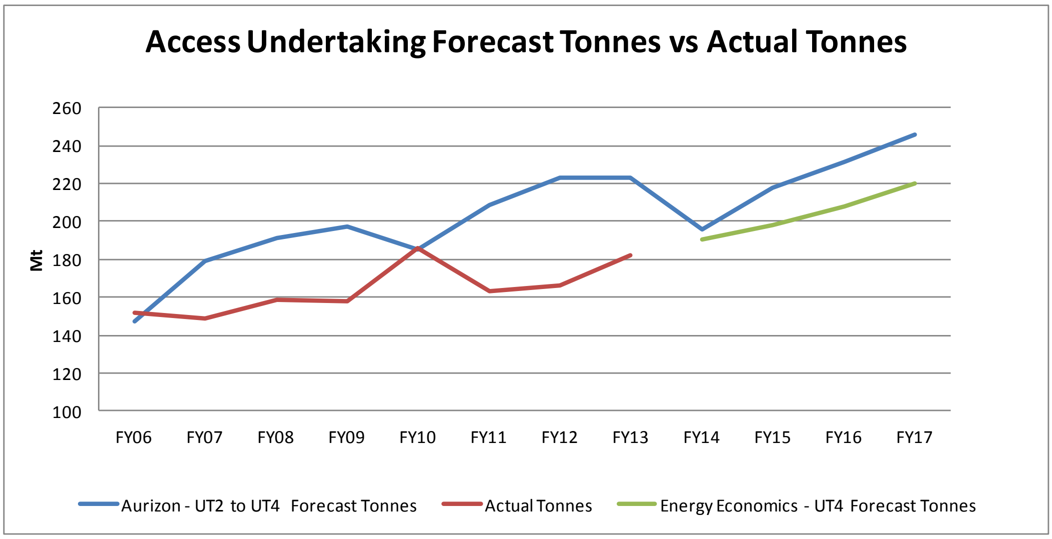
10. Volume Forecasts

The DAU forecasts 910.4 million tonnes will be moved in the 4 year regulatory period, compared to 698.1 million tonnes moved in UT3's 4 year regulatory period. There has been consistent overstatement of forecast system tonnages in the previous two access undertakings. Whilst we understand the 910.4 million tonnes represents approximately 75% of contracted volumes, we remain concerned such volumes are still quite bullish given the current global coal market environment. Whilst we endorsed the FY14 volumes used in the Authority's interim tariff decision, the GAPE volumes were considered separately and based on railings to date, look like being overly optimistic for FY14. Similarly, delays in our Hay Point Terminal expansion project (HPX3) reveal that our terminal will not reach a 55 million tonnes annual capacity rating until calendar year 2015.

Energy Economics'[5] independent forecast of coal railings during the UT4 period, identify a total railings forecast of 816Mt from FY14 to FY17, compared with Aurizon Network's forecast of 910Mt.



Forecast and Actual Tonnages from UT2 to UT4

We recommend the Authority adopt the Energy Economics UT4 tonnage forecast as more representative of current conditions and growth projects being progressed within the UT4 timeframe. It is noted that Energy Economics total UT4 coal railing forecast of 816.3Mt is actually less than Aurizon's UT3 railing forecast of 841Mt. However, given our experience with both GAPE railings and an export coal terminal expansion, we recommend the Authority err on the side of caution in terms of the demand forecasts in UT4.

11. Annual Tariff Setting Process

The DAU continues AN's standard approach to building a regulatory model with revenue smoothing to cover the entire UT4 period. This means that AN has presented forecasts of key cost elements which are a step change from those presented in the previous DAU and has had to develop them at least 12 months before the start of the regulatory period so that the DAU forecasts are created outside the time period in which they are going to be given effect (e.g. FY17 tariffs will have estimated five years prior to implementation). This suggests a systemic problem in the forecasting approach used by AN and makes stakeholders' task of reviewing the cost inputs in a rigorous manner very complex and subject to error by omission due to the requirement to focus limited resources on 'big ticket' items.

[5] Energy Economics, *Central Queensland Coal Railings Forecast – A Report for the QCA* , July 2013

To avoid this issue, we recommend the Authority introduce an annual price setting process which considers the forecasts of all the major cost inputs that have shown considerable variation within regulatory periods, including volume forecasts, maintenance costs, aspects of operating costs, actual capital costs incorporated in the Regulatory Asset base in the previous year and the annual capital indicator to be applied for the next year. This annual review process could be undertaken at the time when the Authority previously considered the volume forecast to annually reset reference tariffs to reflect volume movements.

An annual price setting process would remove much of the “heat” involved in this regulatory determination by enabling both AN and producers to consider the market reality within which reference tariffs are being set. It allows for AN, the Authority and stakeholders to review the previous year’s maintenance expenditure and determine whether such expenditure delivered on the scope, standard and cost approved by the Authority.

This will enable a maintenance data series to emerge which will provide direction to AN and comfort to industry that its money is being spent in maintenance activities which generate the sustainable, safe and reliable use of the network. Where there are characteristics of AN’s maintenance activities which make it a relatively unique activity, then efficient benchmarking of those activities will come to reflect an assessment of its previous year’s performance (actual vs forecast). An annual price setting review will also avoid the current price shocks which are experienced by industry when moving from one regulatory period to the next.

12. Central Coordination

The BMA Coal Chain (BMACC) is a functional group within BMA which manages all BMA and BMC’s transport logistics business operations. The coal chain managed by BMACC comprises all mines, ports and rail infrastructure within the BMA and BMC asset portfolio, including:

1. BMC – South Walker Creek and Poitrel mines;

2. BMA – Goonyella, Riverside, Broadmeadow, Daunia, Peak Downs, Saraji, Gregory Crinum, Blackwater mines (Caval Ridge to commence in CY14);

3. Dedicated Export Coal Terminal - Hay Point Coal Terminal (HPCT);

4. Dedicated rail operator - BMA Rail - commencing in the Goonyella System on 1 January 2014;

5. Dedicated rail holding yards on the Caval Ridge rail spur which connects the Caval Ridge mine to the mainline;

6. Multi-User Export Coal Terminal Contractual Entitlements - RG Tanna Coal Terminal, Barney Point Coal Terminal, Dalrymple Bay Coal Terminal and Abbott Point Coal Terminal (FY2012); and

7. Multi-User Rail and AN Contractual Entitlements – Goonyella, Blackwater and GAP-Newlands Systems (FY2012).

BMACC integrates its coal chain logistics planning to optimally match coal production, railing, and shipping resources with customer demand in the operational planning horizon (0-24 months) and within the identified and emerging constraints of the CQCN. Furthermore BMACC interfaces directly with the global BHP Billiton Marketing function to provide an integrated logistics solution which extends to customers.

BMACC manages bi-directional coal movements across the CQCN between the different ports, dependent on blending and market requirements, and monitors performance and optimisation capability to identify opportunities and drive improvement in its operation and throughput capability. In undertaking this role, BMACC closely liaises with all internal and external service providers to manage its planning, scheduling and operational requirements within the capability and constraints of the Coal System. Due to the integrated nature of the

BMACC, its direct coordination of all activities from mine to market ensures reliable delivery of product to the required quality whilst maximising throughput.

It is essential BMACC continues to exercise its own co-ordination of our mines, HPCT terminal, contracts with third party coal terminals and contracts with Aurizon and AN to maintain efficient rail to stock services, and not be constrained by any System Rules or procedures that try to impose a degree of conformance with a very different operating mode of another coal supply chain. In addition, from 1 January 2014, BMA Rail will enter the above rail market in the Goonyella System and will be providing dedicated rail haulage services from our Goonyella mines to HPCT.

Whilst we concur with industry's criticism around AN's failure to provide sufficient transparency in the delivery of rail access services and operational performance data, we do not agree that this situation can only be fixed by transferring the coal chain coordination function out of AN and over to an independent co-ordinator. Rather, we support the Authority considering mechanisms through which AN can be held accountable for delivering more robust and transparent access services and operational performance data.

As you are aware the multi-user rail infrastructure market is only one component of all the markets which exist to provide logistics services to Queensland's coal industry. Other markets include, rail operations (currently 3 rail haulage providers), export coal terminals (currently 4 ports) and shipping logistics connecting coal mines to end customers. With the complexity and interrelationship of all of these markets, it is inevitable there will be a degree of mismatch between rail, port, shipping and mine planning amongst all coal companies operating in Queensland. This is the nature of the Queensland coal industry and a key reason why we invested so significantly in the complementary port and rail infrastructure together with establishing a central supply chain planning function, all of which which are vital to our business success.

Accordingly, we remain sceptical of any notion that an independent coordinating body could identify an overriding whole-of-coal system interest and, further, decide on the right balance between the "collective interest" and limiting the freedom of participants to pursue their own commercial interests. BMACC, for example, could not be reasonably expected to agree with or accede to arrangements on the Goonyella System that would run counter to our interest in optimising the performance of HPCT and its integration with our mines.

13. Transparency and performance to plan

The DAU needs to provide more detail and transparency around AN's performance to plan with respect to maintenance and operational performance. We recommend AN provide one page quarterly reports to all producers outlining:

1. Network Maintenance key performance indicators which outline performance against AN's annual maintenance plan, including:
    - Resleepering (Actual Delivery vs Plan);
    - Resurfacing (Actual Delivery vs Plan);
    - Rail Grinding (Actual Delivery vs Plan);
    - Track Recording (Actual Delivery vs Plan);
    - Ballast Undercutting (Actual vs Plan);
    - Non Destructive Testing (Actual Delivery vs Plan);
    - Routine Maintenance vs Plan;
    - Scheduled closure performance (Actual vs Plan); and
    - Overall Track Condition Index (benchmarked against other heavy haul railways).

2. Network Operations key performance indicators which outline performance against AN's operating (Critical Asset Calendar, Monthly, Intermediate and Weekly) plans, including

   - On timing running (trains operating > 15 mins behind schedule due to below rail causes);
   - Train cancellations due to below rail causes;
   - Below Rail Transit Time (BRTT);
   - Network Availability (percentage of time mainline network is capable of operating trains on normal cycles and showing reasons for unavailability (e.g. scheduled maintenance, unscheduled maintenance and other reasons); and
   - Safety Instances.

We recommend the Authority consider streamlining the definition and calculation of BRRT in the DAU. The current calculation is overly complicated and provides for numerous excusals to almost render it meaningless in terms of identifying and confirming whether AN has delivered services within the BRTT. We request the Authority consider amending the definition of BRTT to include Above Rail Causes so that BRTT can clearly identify both network and train congestion impacts on the network. BRTT would then provide a better operational signal for customers to consider the different investment trade-offs between below and above rail infrastructure to maintain BRTT at an acceptable operational margin. For example if crewing changes and provisioning is occurring on the network then this activity needs to be captured in BRTT. AN can then be held accountable for ensuring sufficient below rail infrastructure exists to deliver to the different operating plans contained within its access agreements.

The DAU also needs to be amended to incorporate our recent submission to the Authority on the Northern Bowen Basin System Rules. Our amendments recommend greater transparency around our contractual entitlements and gathering of performance data for industry to be confident AN is delivering on its contractual obligations. Greater transparency by AN in reporting on the scheduling, running and consumption of ordered and scheduled train services within the Monthly, Intermediate and Daily train planning process should detail causes for any non-performance of scheduled services, in an aggregated form and on an individual company basis so it is readily available to all Access Holders and End Users. The reporting framework must also contain sufficient flexibility in the consumption of train paths so that producers are not penalised for diversions and rescheduled train services which can be accommodated in the Daily Train Plan without any adverse operational impacts on existing scheduled train services.

14. Next steps

It is recommended the Authority give consideration to how the DAU process will be conducted from this stage forward (i.e. post stakeholder submissions to the Authority). We are concerned that with the sheer size and complexity of the DAU, including the unreasonable delays in AN submitting the document to the Authority, there is insufficient time for an approved undertaking, which comprehensively reviews and addresses commercial risks and potential unintended consequences, to be in place by 1 July 2014.

We recommend the Authority give consideration to the following options to ensure timely consideration of all the issues contained in the DAU.

1. Separating the issues in the DAU into two categories, namely Price and Non Price Components, and consider releasing Draft and Final Decisions on each component, with priority being given to a Final Decision on the Price Components before the end of FY14.

Pricing Component to be finalised by May 2014

The benefit this approach would be that it would allow the Authority, AN and industry to focus on all cost components of the DAU and deliver to timelines which could include

a. a Pricing Draft Decision by December 2013;
b. stakeholder submissions on the Draft Decision by early February 2014;
c. a Pricing Final Decision by early May 2014;
d. Reconciliation of existing FY14 interim tariffs to true-up any outstanding liabilities or credits within FY14;
e. Enabling industry to accurately plan its FY15 Budget cost base with Authority approved FY15 access charges; and
f. Allowing AN and industry FY16 and FY17 budgets to be finalised via a new Authority approved annual reference tariff setting process which allows the Authority and industry to consider AN's up to date costing information, performance data on previous Financial Year expenditure prior to the commencement of each subsequent Financial Year within the regulatory period.

If the UT4 pricing components are resolved then AN could submit a Draft Amending Access Undertaking to the Authority to extend UT3 until the end of 2014 with the inclusion of new pricing schedule for the Authority's approved FY14 and FY15 reference tariffs as per its Final Decision on the 2013 DAU Pricing Component.

Non-Pricing Component to be finalised by December 2014

The benefit this approach is that it would enable the Authority, AN and industry to further consider on all non-pricing components of the DAU without being held to ransom by the current 30 June 2013 deadline of UT3. This approach could be delivered according to the following proposed timetable:

a. a Non-pricing Draft Decision in early February 2014;
b. stakeholder submissions on the Draft Decision by early May 2014;
c. a Non-pricing Final Decision by August 2014;
d. AN preparing all UT4 documentation for implementation as a cohesive document (re-joining pricing and non-pricing components) in October 2014; and
e. Authority approval of an integrated UT4 document by early December and effective from 1 January 2015.

2. Request the Queensland Government to amend the *Queensland Competition Authority Act 1997* (**the Act**) to remove the real possibility of a worst case scenario occurring at the end of June 2014 where UT3 expires and the DAU has not been finalised.

   a. If UT3 expires without AN triggering an extension and without the Authority being in a position to approve AN's proposed voluntary DAU, then the Queensland rail infrastructure market falls into "no man's land":

      i. There are no approved Reference Tariffs applying to coal haulage on the network;
      ii. AN cannot levy any access charges because industry's Access Agreements reference the Authority's approved Reference Tariffs (default could be the FY14 interim reference tariffs but not certain);
      iii. AN may consider its commercial interests and whether to continue or stop operations given the lack of clarity around whether it can invoice industry to recover costs from any services provided under existing Access Agreements; and

iv. Industry may injunct AN to enforce the provision of services consistent with access agreements at rates equivalent to UT3 FY14 Interim Reference Tariffs (based on legal precedent).

The Act does not take into account the real threat posed should any party to the DAU process seek to push resolution of the 2013 DAU to a situation of brinkmanship, thereby forcing one party to the negotiation process to make concessions they would not otherwise have freely given. Such an outcome runs counter to the regulatory principles contained in the Act. Accordingly, we recommend the Authority identify the means through which the Queensland Government can avert such an outcome whilst also ensuring the Queensland coal rail infrastructure network continues to operate effectively from 1 July 2014.

3. Issue AN with an Undertaking Notice under sections 135 or 136 of the Act, requiring AN to submit an involuntary access undertaking within 60 days of the notice being issued. By issuing the undertaking notice process, the Authority could ensure that it would be in a position to impose a UT4 outcome on AN within 5-6 months of the notice being issued.