



**QRC SUBMISSION**  
**MAIN SUBMISSION**  
10 OCTOBER 2013

10 October 2013

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### **Aurizon Network's draft 2013 Undertaking ('UT4')**

Thank-you for the opportunity to provide this submission on Aurizon Network's draft 2013 Undertaking ('UT4').

#### *Background*

This is the first undertaking to be submitted by Aurizon Network post the privatisation of Aurizon Holdings in 2010. In this document, Aurizon Network seeks to significantly reduce the constraints on its monopoly power which existed under the previous undertaking. Aurizon Network seeks a regulatory model in which it can 'negotiate' access conditions for expansions with access seekers, free of effective regulatory oversight. This is not the business which Aurizon's shareholders purchased, and it is not a model which will promote investment in the Queensland coal industry. A model which relies on negotiations with a monopoly to deliver efficient outcomes is fundamentally flawed.

#### *The importance of UT4*

UT4 is a critical document to the future of the coal industry in Queensland. If approved in its current form, it will adversely impact on the future of existing coal mines and provide strong disincentives to further investment in the Queensland coal industry. QRC does not consider that the draft UT4 is in the public interest, including the public interest in having competition in rail haulage and coal markets, and it is not in the interests of persons who may seek access to the service. The draft UT4 promotes Aurizon Holding's interests, beyond what would be consistent with Aurizon Network's legitimate business interests.

#### *Engagement with Aurizon Network so far*

QRC acknowledges the efforts of Aurizon Network to consult with the QRC and coal producers following the submission of UT4 to the QCA in April. To date, this process has not yielded any

tangible results, and because industry has no countervailing power, there is little to no prospect of reaching negotiated outcomes. Accordingly, UT4 is wholly unsatisfactory to the coal industry.

#### *Industry's significant concerns with UT4*

##### Overview

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- First undertaking submitted since privatisation is wholly unacceptable to industry
  - Protections offered in UT3 prior to privatisation removed
  - Investment obligation (\$300m) for expansions removed
  - User funding model, promised under UT3, still in development
  - Incentive regime, promised under UT3, still in development
  - Seeks to remove regulatory oversight of 'Access Conditions' – the mechanism through which Aurizon captures above-regulatory returns. QRC considers that Aurizon should be prohibited from seeking above regulatory returns until a viable suite of expansion funding obligations is developed.
  - Expansion process gives Aurizon effective control over which mines develop and when.
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##### Cost impacts

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- Average tariff increases estimated at 36%\*
  - Non-electric tariff increases average 45%\*
  - Increases will worsen if volumes reduce. QCA's consultant, Energy Economics, estimates a 94mt shortfall (10%) over the UT4 period compared to Aurizon's forecast
  - Maintenance cost increase 28%\*
  - Operating cost increase 44%\*
  - Aurizon seeks a cost of capital (WACC) of 8.17%. QRC expert advisors support 5.65%.
- 

\*Source: QCA consultation paper August 2013

UT4 is an ambit claim and a disappointing starting point for this process. Coal producers and their suppliers are implementing sweeping efficiency improvements across their businesses in order to remain globally competitive. Aurizon Network stands alone in the industry, seeking to claim substantial cost increases across maintenance, operating costs and corporate costs.

Aurizon Network's WACC claim features a range of upwardly biased inputs which cumulate to a significant overestimate of the cost of capital. This includes a proposition that Aurizon has an equity beta of 1, equivalent to the market average. This is proposed for a business in which revenues are virtually guaranteed, and costs can be adjusted to the point of approaching a pass-through arrangement. Aurizon's approach to successive undertakings has been to identify and eliminate risks, whether material or otherwise. Aurizon has been extremely successful in this process and this success should be reflected in Aurizon Network's WACC.

#### *What industry proposes*

QRC seeks an undertaking which promotes efficient operation of, use of, and investment in, the Central Queensland Coal Network. This should include improvements such as efficient transfer mechanisms, an efficient and equitable expansion process, improved supply chain coordination, effective network development planning, a genuine and transparent capacity assessment process, a streamlined process for connecting infrastructure and effective and robust rules to protect against

the conflicts inherent within the Aurizon Group. Access charges should be based on efficient costs and on a WACC which is a genuine reflection of the low risk of Aurizon Network's business. It is important that the opportunity to develop such an undertaking is not lost as a result of the extreme starting position taken by Aurizon Network and adherence to a target completion date.

QRC's members also seek a package of mechanisms through which investment in expansion of the network can proceed and which restrict the exercise of monopoly power. This needs to include an effective user-funding framework, a commitment by Aurizon Network to fund a reasonable level of expansion projects at regulatory returns, and an option which is suitable for small-medium sized projects and system enhancements which are not expansions. Until such a suite of funding options is in place, QRC considers that the approved undertaking should explicitly prohibit Aurizon Network from investing in the network other than based on regulatory returns and conditions.

*Process going forward*

QRC remains committed to continuing its engagement with Aurizon Network and the QCA in pursuit of the above goals, in parallel with the QCA's assessment process. We understand that the QCA faces a challenging task given the extent of changes proposed by Aurizon in this undertaking and the lack of consultation which occurred prior to its submission.

QRC supports the QCA undertaking a thorough assessment process and encourages all parties to consider options for ensuring that the June 30 expiry of UT3 does not create an artificial deadline. Timing is secondary to the quality of the outcome.

Thank-you for your consideration of our submission.

Yours sincerely

A handwritten signature in black ink that reads "Michael Roche". The signature is written in a cursive, flowing style.

Michael Roche  
**Chief Executive**

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# Executive summary

## 1 About the QRC

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The Queensland Resources Council (**QRC**) is a non-government organisation representing companies that have an interest in exploration, mining, minerals processing, gas and energy production. It is the resource industry's key policy-making body in Queensland, working with all levels of Government, interest groups and the community.

The QRC's membership is comprised of all Queensland coal producer companies, and represents a number of emerging companies that are on the cusp of commencing production.

This submission has been developed by a working group of the QRC comprised of 12 coal company representatives, officers of the QRC and advisers.

## 2 Structure of QRC's submission

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The QRC is grateful for the opportunity to provide this submission.

The QRC's submission is comprised of:

- (a) Section 1: Main submission document. This submission document is largely prepared in the order of the draft UT4.
- (b) Section 2: Mark-ups of parts of the draft access undertaking and associated documents. Again this document is prepared in the order of the draft UT4.
- (c) Section 3: Pricing submission (including the QRC's submission on the WACC, operating costs, maintenance costs and ballast fouling).

References to the QRC's submission are to all three sections mentioned above.

## 3 A gulf of issues

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Aurizon Network has consulted with the QRC since submission of UT4 to the QCA. There was no consultation on UT4 with the QRC or industry prior to its submission. Since submission of UT4, Aurizon Network and the QRC have also attempted to negotiate parts of UT4. To date those discussions have not been fruitful. However, the QRC remains committed to an open dialogue with Aurizon Network.

As is noted in the QRC's covering letter, UT4 is the first undertaking submitted since Aurizon was privatised. The coal industry had serious concerns about the effect that privatisation may have on the efficiency and competitiveness of the below rail service and on the approach which a privatised monopoly service provider would take to its business. Those concerns have materialised during UT3 and in the draft UT4.

UT4 involves a re-write of large portions of the undertaking. The QRC does not in principle object to changing the undertaking. Certainly UT3 (which remains incomplete more than three months after its scheduled expiry) was not a perfect document. UT4 should be assessed against what a good undertaking looks like<sup>1</sup>. However, it is the case

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<sup>1</sup> That is, an undertaking which is efficient, reasonable and workable.

that the changes from UT3 to UT4 move only in one direction – in Aurizon Network’s favour. UT4 provides Aurizon Network with higher charges, less effective regulation of Aurizon Network’s activities and more discretion. The end result, if approved, would be that industry is exposed to monopolistic activities with few checks and balances.

## 4 Executive summary

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Below is a high level summary of the QRC’s submission. It should be read in conjunction with the remainder of the submission.

### 4.1 Part 2: Scope

The undertaking should acknowledge that there are some services for which the only feasible service provider is Aurizon Network. These services should be listed in the undertaking and pre-agreed terms and compensation developed for their governance. The QRC has suggested a list of associated services.

### 4.2 Part 3: Ring-fencing and protections against conflict

Aurizon Network has narrowed the ring-fencing obligations from those contained in UT3. For example, Aurizon Network has narrowed the ring-fence to ‘core’ access related matters.

Since publishing UT3, the Aurizon Group has secured interests in ports (such as Abbot Point) and new rail infrastructure developments (such as the Galilee). The Aurizon Group has made much of the fact that it is an integrated business and that it intends to leverage that integrated model<sup>2</sup>. It is clear when discussing UT4 with Aurizon, and even clearer when reading UT4, that UT4 is an Aurizon Corporate document and not an Aurizon Network document. It has been developed to leverage the integrated model.

The QRC considers that Part 3 needs to be wholly re-written. The goal of that re-write should be to protect against the conflicts inherent in Aurizon’s structure. It should more effectively ring-fence Access activities from all others. There should be a prohibition on secondments and contracts with Aurizon related entities, except where specifically approved by the QCA (and in that circumstance after a public consultation process).

### 4.3 Part 4: Negotiation framework

The QRC has proposed a number of changes to Part 4 of UT4. The primary reason for those changes is to improve the administration of access applications and the access negotiation process.

Changes proposed by the QRC include:

- (a) An obligation on Aurizon Network to notify an access seeker if the access seeker’s access application is not compliant;
- (b) Clarifying that it is not necessary for an access seeker to hold supply chain rights at the time of negotiating an access agreement (rather that the access seeker must establish that it has a reasonable likelihood of obtaining supply chain rights sufficient for its access rights sought); and
- (c) An acknowledgement that a rail haulage operator may only seek or hold access where it does so on behalf of a customer.

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<sup>2</sup> Please see for example investor briefings

#### 4.4 Part 5: Access agreements

The QRC does not propose any changes to Part 5 of UT4. It does however propose changes to the standard access agreements.

Like in UT3, Aurizon Network included a package of standard access agreements in UT4. For the purposes of this submission, the QRC focused only on the Access Holder Access Agreement – Coal (**AHAA**) but considers that its comments and proposed amendments to the AHAA should be applied (as relevant) to all UT4 standard access agreements.

Of primary concern to the QRC is Aurizon Network's disproportionate allocation of risk and liability under the AHAA. In its current form, Aurizon Network totally circumvents liability to operators, has very limited accountability to access holders (including where loss or damage is caused by Aurizon Network) and is entitled to adjustments to reference tariffs in circumstances irrelevant to Aurizon Network's performance of its contractual obligations. Whilst the QRC accepts that Aurizon Network's liability under the AHAA should be limited, it seeks a meaningful liability cap and regime than currently exists. The QRC has proposed amendments to the AHAA which attempt to more appropriately address the interests of both Aurizon Network and access holders against the background of the risk profile agreed in UT4.

In the QRC's view, Aurizon Network has also been unreasonable in its drafting of other key areas of the AHAA, including in relation to supply chain rights and the resumption and transfer of access rights. The QRC's comments on these provisions are centred at reaching a more reasonable and commercial approach to these issues.

#### 4.5 Part 6: Pricing principles

In relation to expansions, the QRC proposes the following pricing principles:

- (a) If the average cost of an expansion across existing and new/expanding access holders would increase access charges paid by existing access holders, a new reference tariff should apply to the expansion. That is, new/expanding access holders should pay the incremental cost (capital and operating);
- (b) If an expansion has a lower cost than one or more earlier expansions, the cost should be averaged down with the most expensive prior project; and
- (c) If an expansion delivers clear benefits to existing users, an allocation of costs may be appropriate.

The QRC recognises that it will not be possible to draft for all scenarios. The QRC therefore proposes that the undertaking contain guiding principles regarding pricing of expansions and that the QCA consider the application of the principles on a case by case basis.

In addition to the principles for expansions, the QRC propose a number of changes to UT4 Part 6. A number of those changes are proposed to correct errors or ambiguity in drafting.

#### 4.6 Part 7: Capacity allocation and management

UT4 Part 7 deals with a number of matters including mutually exclusive access applications, renewals, transfers and system rules. In summary, the QRC proposes:

- (a) That mutually exclusive access applications should be assessed using objective criteria and not by regard to Aurizon Network's legitimate business interests, revenue adequacy and marginal value;

- (b) That a more efficient and user-friendly transfer arrangement is developed. That should include shorter timeframes for Aurizon Network to facilitate transfers and a regime where customers within a geographic cluster can have transfers pre-approved. In a more cyclical coal price environment there is likely to be greater peaks and troughs in coal production. Correspondingly, there will be a greater need for transfers, and in particular short term transfers; and
- (c) System rules are crucial in train scheduling. There should be an obligation on Aurizon Network to develop system rules for each system. Amendments to system rules should be approved by the QCA and not be subject to unilateral amendment by Aurizon Network.

#### **4.7 Part 8: Network development plan and expansions**

Part 8 covers a broad field of matters from studies to expansions, SUFA related provisions, capacity assessment, the network development plan and voting processes.

The expansion process (being the process from concept study to execution of documents for an expansion) provides Aurizon Network with a significant amount of discretion and removes any meaningful regulatory oversight. The QRC requires a process that is prescriptive, objective and efficient. Aurizon Network's base position is one of negotiation. The QRC does not consider that a regulatory model which relies on negotiation with a monopoly service provider in the absence of effective dispute resolution is workable.

Part 8 requires additional provisions to facilitate SUFA. These include an obligation on Aurizon Network to submit the SUFA costs to the QCA, to consult with user funders about a submission to the QCA and an obligation to seek tax rulings.

The capacity assessment process proposed in UT4 lacks rigour and transparency. Aurizon Network should be obliged to consult with relevant parties and obtain an independent report. Capacity assessments should be undertaken regularly.

Industry's experience with planning documents is that they have been of little utility. The QRC has proposed some changes with a view to improving the utility of the network development plan.

The expansion voting process has been re-written in UT4. It has been expanded to cover scope and standard of works. The QRC proposes that voting be limited to scope of work and that a process more similar to that used in UT3 be adopted.

#### **4.8 Part 9: Connecting infrastructure**

The QRC does not propose any change to the standard rail connection agreement.

Substantial change is proposed to Part 9 of UT4 to make it workable. It is not clear from Part 9 what agreements are needed to connect private infrastructure to Aurizon Network's rail infrastructure. This seems to be by design – in that it appears likely that Aurizon Network intends to require agreements in addition to a rail connection agreement and construction agreement as a condition to it consenting to a connection. Aurizon Network's obligation to negotiate with a private infrastructure developer is limited to an access seeker. In the QRC's view, this obligation should also extend to access holders and other private infrastructure developers.

#### **4.9 Part 10: Reporting**

Aurizon Network has considerably narrowed its reporting and auditing obligations from those contained in UT3. Critically, Aurizon Network has removed all ongoing obligations for annual audits, relaxed its operational reporting requirements from quarterly to annual reporting and sought to remove QCA involvement in the selection of auditors.

The QRC considers transparency and the preservation of stakeholder confidence to be paramount in UT4. The QRC seeks the re-introduction of these key obligations from UT3 and an overall more comprehensive reporting and auditing regime.

#### **4.10 Part 11: Dispute Resolution**

Aurizon Network has materially reduced the scope of the dispute resolution procedures from those included in UT3. Under UT3, the dispute resolution process applied generally in respect of the operation of, or anything required to be done under the undertaking. UT4 instead restricts the application of the dispute resolution procedures to those matters that UT4 expressly states are to be resolved in accordance with undertaking.

The QRC considers dispute resolution to be an integral component of the accountability of Aurizon Network to its users. It is therefore imperative that the dispute resolution process apply to a broad range of matters which may arise under the Undertaking. To this end, the QRC is also seeking less rigidity in the alternative dispute resolution mechanisms in UT4, the imposition of cost implications for parties who unreasonably delay dispute resolution processes and less constraint on the QCA's ability to determine a dispute.

#### **4.11 Schedule E**

QRC proposes a number of amendments to the proposed Schedule E. In particular, the circumstances in which the RAB may be reduced (deterioration in demand such that regulated prices on an unoptimised asset would result in a further decline in demand, actual bypass and excessive deterioration of condition of assets) should be restored to those contained in UT3.

#### **4.12 Schedule F**

QRC seeks a number of amendments to the proposed Schedule F.

Schedule F includes numerous changes designed to further reduce Aurizon Network's risk profile. Aurizon Network's approach to successive undertakings has been to identify and eliminate risks, whether material or otherwise. Aurizon Network has been very successful in this process and this success should be reflected in Aurizon Network's WACC.

The changes sought by the QRC with respect to Schedule F include:

- Inclusion of diesel as reference train services. The risk and uncertainty created by the proposal to limit reference train services to electric trains in the Blackwater (other than Rolleston and Minerva) and Goonyella systems is unacceptable.
- Reversal of inappropriate amendments to take or pay arrangements which would benefit the holder of UT1 Access Agreements (Aurizon Operations).
- Seeking genuine progress on the long standing issue of the incentive mechanism. UT4 does not progress this issue, other than to propose an additional incentive to benefit Aurizon Network which is not symmetrical.
- Removal of certain new adjustment mechanisms which seek to move Aurizon Network closer to a cost pass-through arrangement.
- Removal of the mechanism which effectively brings AT1 into the revenue cap, eliminating the last meaningful exposure of Aurizon Network to (a minimal level of) volume risk.

- Removal of the proposed inappropriate allocation of costs associated with the purchase of electricity to AT3/4.
- Removal of the new exclusions from the definition of “Aurizon Network Cause”, which would have the effect of imposing ToP on access holders for shortfalls beyond their control.
- Maintaining regulatory oversight of the EC charge.
- Deletion of the proposed operator capping of ToP.

#### **4.13 SUFA**

The QRC has proposed some SUFA related changes to Part 8 of UT4. Otherwise, the QRC incorporates by reference its SUFA submission of 30 August 2013.

#### **4.14 Incentives**

Aurizon Network has proposed an extension of the circumstances in which it can earn an increment to those provided in the UT3 Draft Incentive Mechanism (DIM). Consistent with the QRC’s submission regarding the UT3 DIM, the QRC does not support Aurizon Network being able to earn an incentive unless it is part of a balanced package of mechanisms which provide appropriate and reciprocal incentives. The QRC therefore objects to the UT4 incentive.

The QRC is in favour of the inclusion of a genuine incentive regime in UT4 and encourages further investigation by Aurizon Network (including meaningful consultation with industry) and the QCA into the formulation of an appropriate framework. Like Aurizon Network, the QRC intends to further consider its position regarding an appropriate UT4 incentive mechanism once the QCA releases its draft decision in relation to the UT3 DIM.

#### **4.15 WACC**

The QRC propose a nominal vanilla WACC for UT4 of 5.65%. This is supported by a detailed submission, and expert reports from McKenzie & Partington and Castalia.

#### **4.16 Operating expenditure**

The QRC has a number of key concerns regarding Aurizon Network’s proposed operating expenditure. These concerns include the significant increases in Aurizon Network’s:

- System Wide and Regional Costs;
- Electricity transmission connection and supply costs; and
- Risk and Insurance costs.

In its submission, the QRC has detailed what it considers to be the reasonable basis for each of these costs to be assessed, applying established regulatory principles.

#### **4.17 Maintenance costs**

The QRC has a number of key concerns regarding Aurizon Network’s proposed maintenance submission, including in relation to:

- the significant increases in Aurizon Network’s overall maintenance allowance;
- the accuracy of the UT4 tonnage forecasts relied upon in UT4;

- the potential for non-delivery of maintenance scope;
- the increasing need for and cost of ballast undercutting intervention in UT4; and
- the feasibility of the methodology proposed by Aurizon Network for a return on assets and allocation of corporate costs to the maintenance function.

These issues are addressed in detail in the QRC's submission. The QRC proposes that substantially more work needs to be undertaken to verify these costs.

# Regulatory policy submission

## 1 Overview

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This part of the submission provides an overview of the principles underlying access regulation and explains why, in light of the factors to which the Queensland Competition Authority (**QCA**) must have regard in exercising its broad discretionary powers, it is not appropriate to approve the 2013 draft access undertaking (**UT4**) in its current form. In brief:

- 1 while competition produces a variety of benefits to society (including increased efficiency), the existence of 'natural monopolies' means that competition is not always possible or even desirable and regulation is needed to encourage efficient outcomes;
- 2 regulation can take various forms but the key objective generally involves seeking to redress the inequality of bargaining power between dependant users and monopoly service providers and preventing the misuse of monopoly power;
- 3 under the Queensland regime, the owner or operator of a 'declared' service can be required to submit a draft access undertaking to the QCA for approval. The QCA may decide to approve the draft access undertaking only if it considers it appropriate to do so, having regard to various factors. The exercise of this broad discretion is subject to judicial review, but not merits review;
- 4 the use of the Central Queensland Coal Network (**CQCN**) for providing transportation by rail is a 'declared' service. Aurizon Network (**AN**) has submitted a draft access undertaking to the QCA for approval. The draft access undertaking proposes a fundamental shift in the balance of power between itself and access seekers; and
- 5 it is not appropriate to approve a draft undertaking which proposes such a fundamental shift because:
  - access seekers do not have countervailing power when negotiating with Aurizon Network. They have no credible alternatives and cannot negotiate effectively with, or police the behaviour of, a vertically integrated monopoly service provider like Aurizon Network;
  - access holders have made long term investment decisions and entered into long term contracts based on a reasonable expectation of there being a stable and certain regulatory framework for below rail access. As the QCA has recognised in previous decisions, there is a clear public interest in providing regulatory certainty and the fundamental changes proposed by Aurizon Network are inconsistent with that goal;
  - changes to the underlying nature of an access regime should not be made without careful consideration and compelling evidence that misuse of monopoly power concerns can be managed. This is not the case here; and
  - radically altering the regulatory framework in this challenging economic climate would not further the purpose of the access regime, the interests of access seekers or be in the public interest. In approving the existing access undertaking, the QCA recently determined an appropriate balanced position and there have been no

changes in Aurizon Network's business or the market which would justify fundamentally altering that position. While Aurizon Network has a legitimate interest in earning a reasonable return on its efficient investment, it is able to do so without fundamentally altering the balance of power and weakening mechanisms that have been put in place to try to limit the exercise of monopoly power.

## 2 The need for access regulation is widely accepted

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Competition produces a wide variety of benefits for society. However, some markets involve 'natural monopolies' and can often be supplied most efficiently by a single firm. In this situation, it is well recognised that an appropriate form of regulation is required to drive efficient outcomes.

### 2.1 Competition produces benefits but is not always possible

Actual or potential competition leads to significant benefits to society. At its simplest, the benefits of competition are lower prices, better products, wider choice and greater efficiency than under monopoly conditions<sup>3</sup>. Competitive rivalry encourages firms to maximise efficiency. Firms which do not constantly strive for improved efficiency, risk being overtaken by more efficient rivals.

The important role of competition was most recently emphasised by the Australian Competition and Consumer Commission (**ACCC**) in its submission on the Productivity Commission's ongoing review of the national access regime (**NAR**) in Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**) where it noted that 'competition will maximise productivity and community welfare'<sup>4</sup>.

However, competition is not always possible or even desirable. Some markets involve inherent failures which mean that competition is neither achievable nor sustainable in the long term<sup>5</sup>. This is the case for markets which involve what is known as a 'natural monopoly'.

### 2.2 The natural monopoly problem

The term 'natural monopoly' is generally used by economists to describe the situation where demand for a particular good or service can be most efficiently supplied by a single firm<sup>6</sup>. That is, the 'natural' state of the market which results in the most economical use of society's resources involves having only one supplier.

However, without actual or potential competition, efficiency benefits will be lost and there is a risk that the monopoly service provider will:

- use its market power to raise prices and earn monopoly rents<sup>7</sup>, especially where barriers to entry are high and users do not have any real countervailing power (i.e. there is no credible bypass)<sup>8</sup>; and

<sup>3</sup> R Whish and D Bailey *Competition Law* (7<sup>th</sup> Ed, 2012) 4.

<sup>4</sup> ACCC submission, *Productivity Commissions Review of the National Access Regime* (February 2013) (**ACCC Submission**) 71.

<sup>5</sup> P Areeda, L Kaplow and A Edlin, *Antitrust Analysis Problems, Text and Cases* (6<sup>th</sup> Ed, 2004) 23.

<sup>6</sup> A Kahn *The Economics of Regulation: Principles and Institutions* (2<sup>nd</sup> Ed, 1988) 11/1.

<sup>7</sup> Report by the Independent Committee of Inquiry, *National Competition Policy* (August 1993) (**Hilmer Report**) 241.

<sup>8</sup> Productivity Commission *National Access Regime Productivity Commission Draft Report* (May 2013) 83.

- have a reduced incentive to innovate or improve goods and services (i.e. to maximise its dynamic efficiency)<sup>9</sup> and may also delay investment so that investment falls below the socially optimal level<sup>10</sup>.

To address these concerns, various governments have introduced regulation to manage access to significant facilities and the services that they provide.

## 2.3 Regulation is required to address the natural monopoly problem

In 1992, the States, Territories and the Commonwealth agreed to an independent inquiry into the need for a single national competition policy. The report produced by the inquiry (the **Hilmer Report**) concluded that, for certain essential facilities such as rail infrastructure, there was a 'strong public interest in ensuring effective competition can take place'<sup>11</sup>.

Following the release of the Hilmer Report, the Commonwealth, State and Territory governments agreed that an access regime was needed to address the issues raised by natural monopolies and introduced the NAR<sup>12</sup>.

In 2001, the Productivity Commission conducted a detailed review of the NAR. It concluded that the regime should be retained, stating that:

'the natural monopoly characteristics of a number of essential infrastructure services mean that an explicit mechanism for facilitating efficient third party access is likely to be desirable'<sup>13</sup>.

The Productivity Commission is currently conducting a further review of the NAR. In its recent draft report (**Draft PC Report**)<sup>14</sup> the Productivity Commission again reached a similar conclusion, finding that revoking the NAR 'may do more harm than good'<sup>15</sup>. This sentiment was echoed by a number of parties, including users of essential infrastructure such as the CQCN. For example, Asciano commented that<sup>16</sup>:

'If the National Access Regime were removed and not replaced with an alternative regime then many activities currently undertaken, including above rail activities, would become problematic at best'.

While it is widely accepted that the problem of natural monopoly requires regulation, there are a range of different approaches that can be taken to tackling the problem.

## 2.4 There are different forms of regulation

There is no 'one size fits all' approach to regulation. There are different forms of regulation and the best form of regulation in a given situation will depend on a range of different factors.

The appropriate form of regulation can range from anything from a regulator mandating standard access terms and setting tariffs, to lighter forms of regulation such as a

<sup>9</sup> See for example, *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2 at paragraph 519.

<sup>10</sup> Productivity Commission *Review of the National Access Regime – Inquiry Report* (September 2001) (**2001 Report**) 72.

<sup>11</sup> Hilmer Report at 248.

<sup>12</sup> Competition Principles Agreement (11 April 1995).

<sup>13</sup> 2001 Report at xx.

<sup>14</sup> Final version of the Draft PC Report is due to be submitted to government in October 2013.

<sup>15</sup> 2013 Report at 16.

<sup>16</sup> Asciano, *Submission to the Productivity Commission – Asciano submission to the Productivity Commission issues paper on the national access regime* (February 2013) (**Asciano Submission**) 13.

negotiate-arbitrate framework, where commercial negotiations occur between the access seeker and provider with a regulator resolving any disputes through arbitration, or price monitoring.

## 2.5 The choice of the appropriate form of regulation must be made very carefully.

The level of regulation which is appropriate will depend on the relevant commercial context and should respond to the degree of power enjoyed by the incumbent monopoly service provider<sup>17</sup>.

In its Draft PC Report, the Productivity Commission suggested that the following questions should be considered when deciding which form of regulation to adopt:

- is there likely to be a large number of access seekers for the service?
- is negotiation of access agreements likely to be complex?
- are capacity constraints likely to lead to insufficient services being available for access seekers?<sup>18</sup>

If the answer to these question is 'yes', the Productivity Commissions suggested that 'full regulation might be applied'<sup>19</sup>. Otherwise, a lighter form of regulation may be more suitable. For example, a lighter form of regulation may be appropriate where users have credible opportunities for bypass and can exercise genuine countervailing buyer power.

Caution should be exercised before moving to lighter regulation. Compelling evidence is required before allowing a monopoly service provider to enjoy greater flexibility. Serious consequences can follow if lighter forms of regulation are adopted while monopoly power concerns persist. For example, it can lead to inefficient outcomes, such as lengthy negotiations and protracted disputes. This is precisely what happened in the telecommunications industry.

Between 1997 and 2010 the telecommunications access regime in Part XIC of the CCA operated as a negotiate-arbitrate model. During this period, there were 164 disputes in the telecommunications sector, compared with 4 in other regulated sectors with more detailed regulatory regimes. Eventually, the Commonwealth government decided to introduce a more detailed form of regulation (including the ACCC setting access prices). The Explanatory Memorandum to the bill proposing the reforms acknowledged stakeholder concerns that the existing model was slow, cumbersome and open to gaming (if not outright 'obstruction' from service providers) and that:

'rather than encouraging flexible negotiation, the process has been a source of uncertainty and delay for access seekers'<sup>20</sup>.

As the Explanatory Memorandum acknowledged, in situations where there is the potential for significant inefficiencies due to the misuse of market power, a more direct regulatory regime will lead to 'greater certainty, less disputation and more timely and efficient outcomes'<sup>21</sup>.

<sup>17</sup> National Competition Council *A guide to the functions and powers of the National Competition Council under the national gas law, Part B - Coverage, revocation and classification of pipelines* (v.15, May 2012) 16.

<sup>18</sup> 2013 Report at 129.

<sup>19</sup> 2013 Report at 129.

<sup>20</sup> *Telecommunication Legislation Amendment (Competition and Consumer Safeguards) Bill 2010 Explanatory Memorandum (2008 Telecommunications EM)* 48.

<sup>21</sup> 2008 Telecommunications EM at 55.

### 3 The Queensland access regime

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The owner or operator of a service which has been ‘declared’ under the Queensland access regime can be required to submit a draft access undertaking to the QCA for approval. The QCA has a broad discretion when considering a draft access undertaking and may decide to approve a draft access undertaking only if it considers it appropriate to do so having regard to each of a number of factors, including the object of the access regime, the legitimate business interests of the owner or operator of the service, the interests of access seekers, the public interest and any other issues that it considers relevant. This broad discretion is subject to judicial review, but not merits review.

#### 3.1 Overview of the regime

Following the introduction of the NAR, Queensland introduced a state based access regime as part of the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**). The stated goal at the time of its introduction was to ensure that the interests of the Queensland economy were appropriately recognised by introducing ‘competitive arrangements where the social as well as economic and financial benefits of regulation outweigh the costs’<sup>22</sup>.

At the time the regime was introduced, Queensland had 2 very significant government-owned, multi-user open access facilities (Dalrymple Bay Coal Terminal and the CQCN). The regime applied to those facilities when it was introduced and continues to apply now. In particular, under the QCA Act, the use of the below rail infrastructure of the CQCN<sup>23</sup> for providing transportation by rail is a ‘declared’ service<sup>24</sup>. As a result, third parties have a statutory right to negotiate access terms with the owner / operator. If an access seeker cannot reach agreement, the matter can be referred to the QCA for binding arbitration. The existence of an effective mechanism for resolving disputes is an important element of the Queensland regime. It is a key aspect of the framework which seeks to facilitate meaningful negotiations between dependent access seekers and the monopoly service provider.

The Queensland access regime provides a mechanism for access undertakings to be given to the QCA. Access undertakings can be submitted voluntarily<sup>25</sup> or the regulated owner / operator of a declared service can be required by the QCA to provide an undertaking<sup>26</sup>. If the owner / operator of a declared service does not submit a draft undertaking when requested or does not resubmit a draft undertaking with the amendments required, the QCA can prepare and approve its own undertaking for the relevant declared service<sup>27</sup>.

<sup>22</sup> Hon. J Sheldon, *Queensland Competition Authority Bill – Second reading speech* (30 April 1997) 1131.

<sup>23</sup> The CQCN comprises the rail transport infrastructure of four rail systems: Blackwater, Goonyella, Moura and Newlands and any rail transport infrastructure directly or indirectly connected to those systems, but not any additional coal basins which were not connected to the system on 30 July 2010.

<sup>24</sup> *Queensland Competition Authority Amendment Regulation (No. 1) 1998* (Qld) inserted a new clause 4 into the Queensland Competition Authority Regulation 1997 declaring the service. In 2010, the QCA Act was amended so that the use of the CQCN for providing transportation by rail is deemed to be a declared service (section 250(1)). The declaration expires in September 2020.

<sup>25</sup> Section 136 QCA Act.

<sup>26</sup> Section 133 QCA Act.

<sup>27</sup> Sections 135 and 136A QCA Act.

## 3.2 QCA has a broad discretion

The QCA may decide to approve a draft access undertaking only if it considers it appropriate to do so having regard to each of the eight factors listed in section 138(2) of the QCA Act. While the QCA must give each factor due consideration in its deliberations<sup>28</sup>, it is free to determine the appropriate weight to be given to the various factors. Moreover, the last factor allows the QCA to consider 'any other issues' it considers relevant. As a result, the QCA has a broad discretion. The exercise of this broad discretion is subject to judicial review, but not merits review.

### Object of Queensland access regime

In considering a draft access undertaking, the QCA must have regard to the object of the Queensland access regime, which is to:

'promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets'<sup>29</sup>.

This object focusses on promoting efficiency as well as promoting competition. The focus on efficiency was noted by the State when it introduced the new objects clause<sup>30</sup> and more recently by the QCA in its submission to the 2012 PC Review, where it noted that the object of the Queensland access regime is to 'promote the economically efficient operation of, and investment in, significant infrastructure'<sup>31</sup> such as the CQCEN.

### Legitimate business interests of the owner/operator

The QCA must also have regard to the 'legitimate business interests' of the owner or operator of the service. The term 'legitimate business interests' is not defined in the QCA Act. But, as with all statutory interpretation, the term needs to be interpreted in light of the purpose of the relevant act (i.e. the QCA Act)<sup>32</sup>.

As a result, there should be a focus on promoting efficiency and competition. That is, the interests of Aurizon Network which can be taken into account by the QCA are those which are legitimate in the sense of promoting efficiency and competition. For example, costs that have been incurred inefficiently or returns that are not commensurate with the relevant risks should not be considered legitimate. Similarly, any interests that Aurizon Network may have in altering the negotiating balance in its favour should not be regarded as legitimate in the absence of countervailing power because doing so is unlikely to promote the efficient operation, use of or investment in the CQCEN or promote competition in related markets.

This purposive interpretation is in line with the approach adopted by the QCA when it considered the initial access undertaking for the CQCEN. At that time, the QCA considered that the concept of legitimate business interests did not include interests which inhibited competition but did include the interests of the owner or operator to:

<sup>28</sup> *Minister for Aboriginal Affairs v Peko Wallsend* (1986) 162 CLR 24 at 34.

<sup>29</sup> Section 69E QCA Act.

<sup>30</sup> 'The new objects clause places an emphasis on efficient investment in, and use of, infrastructure' Hon. A Fraser, *Queensland Competition Authority Amendment Bill – Second Reading Speech* (13 February 2008) 151.

<sup>31</sup> *Submission to the Productivity Commissions on the National Access Regime* (March 2013) (QCA PC Submission) 6.

<sup>32</sup> Section 14A *Acts Interpretation Act 1954* (Qld).

'recover the efficient costs incurred in providing services over the expected lives of the assets employed and to earn a risk-adjusted rate of return on the value of those assets'<sup>33</sup>.

The ACCC has also considered the concept of legitimate business interests under the NAR when reviewing the Hunter Valley access undertaking. The ACCC accepted a definition of legitimate business interests as:

- recovery of at least sufficient revenue to meet efficiency costs associated with access, having regard to efficient operation of the Hunter Valley coal chain;
- fair and reasonable return on ARTC's investment commensurate with its commercial risk; and
- encouraging customer confidence and market growth in the rail industry generally and the Hunter Valley coal industry in particular<sup>34</sup>.

### Interests of access seekers

The interests of access seekers is another important consideration to be weighed in the process of evaluating a draft access undertaking.

The QCA has previously considered that the interests of access seekers in relation to the QCN includes:

- appropriate ring-fencing arrangements;
- an effective negotiation framework, which includes the provision of information to third-party operators in a timely manner, clearly defined boundaries to access negotiations and effective dispute resolution procedures;
- preventing the exploitation of the service provider's monopoly position in respect of below rail services, including through offering preferential pricing terms to its above rail operations and charging excessive access prices to access seekers;
- ensuring barriers to entry, such as excessive safety and environmental requirements, have not been incorporated into the undertaking; and
- appropriate incentives to improve efficiency and service performance over time<sup>35</sup>.

### Public interest

The public interest is another factor which the QCA must take into account when considering a draft access undertaking.

The concept of the public interest is not fully defined in the QCA Act, although it is stated to include an interest in having competition in markets (whether or not in Australia).

The concept of the public interest is generally recognised as needing to be interpreted very widely. For example, it has been described as:

'not a concept subject to definition or prescription by fixed rules... but necessarily changes over time'<sup>36</sup>.

<sup>33</sup> Queensland Competition Authority *Draft Decision on QR's Draft Undertaking, Volume 2 – The Draft Undertaking*, (December 2000) (UT1 Draft Decision) 43.

<sup>34</sup> Australian Rail Track Corporation *Hunter Valley Coal Network Access Undertaking* (23 June 2011) 5.

<sup>35</sup> UT1 Draft Decision at 44.

<sup>36</sup> A Bouris, *Aspects of the concept of Public interest* (15 November 2012) 5.

The High Court in the recent Pilbara rail access matter endorsed a wide scope for the concept of the public interest, stating that it involved a 'discretionary value judgment to be made by reference to undefined factual matters' which was confined 'only by the subject matter, scope and purpose of the statutory provisions'<sup>37</sup>.

The concept should therefore be interpreted widely and the QCA should not limit itself to a mere cost benefit analysis. Rather, the QCA should adopt a broad approach, having regard to wider community benefits which it considers relevant.

In particular, the public interest needs to be considered carefully in the context of long term investments in upstream and downstream markets which rely on the provision of the declared service (such as development decisions for coal mining projects, investment in rolling stock and development decisions for coal export terminals). The public interest is not served by major changes which can undermine investments and have a chilling impact on future investment decisions in the Queensland coal industry.

## 4 It is not appropriate to allow Aurizon Network greater power

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Coal miners do not have countervailing power. They depend on the access undertaking to assist them in their quest to achieve a commercial outcome from negotiations with a monopoly service provider. Access charges are an important issue for coal miners and compelling evidence is required before making significant changes to the existing regime. Any suggestion that it is appropriate to relax the undertaking (such as removing regulatory oversight of access conditions and funding obligations), dilute the dispute resolution procedures or weaken the ring-fencing mechanisms needs to be treated with the utmost caution.

### 4.1 Access seekers do not have countervailing power

As the QCA has recently acknowledged, there are no alternative forms of transport which are competitive to rail in transporting bulk commodities (particularly in respect of coal)<sup>38</sup>.

Coal miners have no credible options for bypass and no countervailing power. Even the largest and most sophisticated coal miners are not able to negotiate with Aurizon Network on an equal footing and there is no real prospect of other miners being able to exercise any semblance of countervailing power.

The disparity in bargaining power has manifested itself most starkly in recent years in negotiation of:

- the Wiggins Island Rail Project (**WIRP**) - this project, which connects the CQCN to the Wiggins Island Coal Export Terminal, was plagued by lengthy delays and insufficient information from Aurizon Network. As the QRC noted in its submission to the QCA on WIRP, access seekers were faced with a choice between accepting terms which may include monopoly rents justified on the basis of extraneous risk-reward assessments or facing significant delays<sup>39</sup>.
- the Goonyella to Abbot Point Expansion (**GAPE**) - this project, which provides the 'missing link' connecting the Goonyella and Newlands rail systems, was also plagued by lengthy delays. The negotiations were so protracted that, as the Access seekers has previously explained, that they were left with no choice but

<sup>37</sup> *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] 246 CLR 379 at 387.

<sup>38</sup> QCA PC Submission at 22.

<sup>39</sup> QRC, *Submission Proposed access conditions: Wiggins Island Rail Project* (16 June 2011) 2.

to accept Aurizon Network earning higher than regulated returns or face significant project delays<sup>40</sup>.

As noted above in section 2.4 in relation to the telecommunications industry, it is not just the rail industry which has experienced protracted delays during commercial negotiations or under more light handed regimes.

These examples provide an indication of what might be expected to happen if the current access undertaking is relaxed so that Aurizon Network can conduct more 'commercial' and 'flexible' negotiations. The undertaking should prevent Aurizon Network from extracting monopoly rent through investment hold up in circumstances like WIRP and GAPE. Any weakening of the regulatory oversight of network expansion investments and contracting as Aurizon Network proposes would only increase the prospects of these problems occurring in the future.

## 4.2 Access charges are an important issue

The Queensland coal industry is competing in increasingly competitive global markets where its international competitors enjoy significant cost advantages. The competitiveness of current and proposed projects is being eroded by a variety of cost concerns including: the persistent strength of the Australian dollar against the US, high labour costs, excessive red and green tape regulation, high effective tax and royalty rates by international comparison and higher proposed rail access charges.

Rail access charges comprise up to ~15% of the total cost of bringing an extra tonne of coal to market. As a result, even a seemingly minor increase in access charges, combined with other cost increases, will have a significant impact on the competitiveness of current operations and a chilling effect on investment.

The decreasing competitiveness of current Queensland coal operations is demonstrated at Chart One below. For thermal coal operations exporting to the Chinese market, 40% of operations in 2006 were in quartiles 3 and 4 of their cost curve, whereas in 2012 this was estimated to be a concerning 76%. Similarly, 26% of metallurgical coal operations exporting to the Chinese market were in quartiles 3 and 4 of their cost curve in 2006, compared to 57% in 2012. Those operations that are unable to stop their slide up and along their cost curve will become uncompetitive in global coal markets.

Recent examples of this include BMA's decision to close the Gregory and Norwich Park mines in the Bowen Basin<sup>41</sup> and XstrataGlencore's decision to curtail production at its Newlands and Oaky Creek mines<sup>42</sup> and suspend operations at its Collinsville mine<sup>43</sup>. In total, the QRC estimates that 8,000 direct jobs and more indirect jobs have been lost in Queensland over the past 12 months.

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<sup>40</sup> QCA PC Submission at 14.

<sup>41</sup> S. Dumble BMA Overview (30 May 2013) 11.

<sup>42</sup> ABC Glencore-Xstrata says 450 jobs to go at coal mines in Queensland (28 June 2013) available at <http://www.abc.net.au/news/2013-06-27/450-jobs-to-go-a-xstrata-glenocore-coal-mines-in-queensland/4785268> accessed on 11 September 2013.

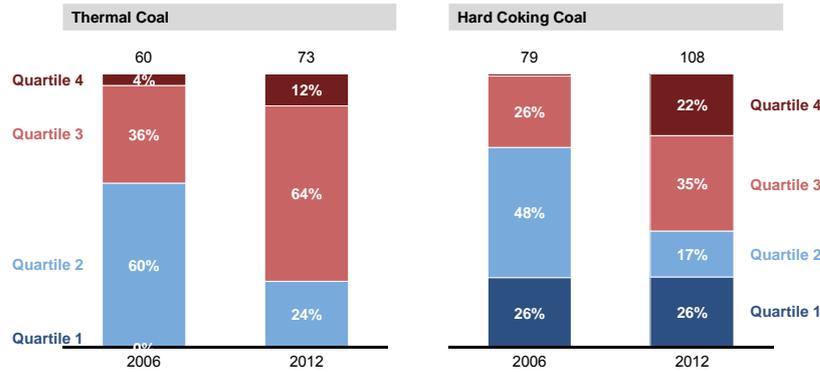
<sup>43</sup> ABC Collinsville miners unsure about regaining Glencore Coal Mine jobs (19 September 2013) available at <http://www.abc.net.au/news/2013-09-19/collinsville-miners-face-job-uncertainty/4968882> accessed on 26 September 2013.

## Chart One<sup>44</sup>

Particularly in thermal coal, Queensland mines are increasingly among the most expensive in the coal sector

### COMPETITIVENESS OF QUEENSLAND MINES – CASH OPERATING COSTS

Percent of production by cost curve quartile, totals in Mt of production; coal delivered to China



\* Q1, Q2, Q3, and Q4 represent the percentage of total Queensland production within the first, second, third, and fourth quartiles of the global cost curve.  
Source: AME

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Unsurprisingly, coal miners are increasingly focussed on constraining costs, including corporate overheads, direct labour costs, reduced contract mining, maintenance and general contractor prices to stay competitive. Reduced transport costs are also needed to complement the incremental improvements made in other areas. Regardless of the business conditions, the coal sector expects that rail access charges will be highly regulated given that the coal miners do not have countervailing power and rely on regulatory safeguards to counteract Aurizon Network's monopoly power.

The impact on new investments from a culmination of higher costs (including rail access charges) on a project's NPV and hurdle rate calculations is likely to be significant. Currently, in excess of \$80 billion in Queensland coal projects have been publically announced or are going through feasibility assessments. However, as of April 2013, only \$6 billion of investment has been committed. This reflects the extremely difficult investment climate at present and Queensland's reputation as a high cost jurisdiction.

Concerns of substantial increases in rail access charges and that Queensland's regulatory framework may be ineffectual in curtailing Aurizon Network's monopoly power will exacerbate the already poor investment sentiment. The Queensland coal mining industry can only be sustained and expanded by mining companies investing. If the economic justification for making further investments in Queensland coal mining is not present then these investments will not be made and the industry will continue to lag behind its global competitors.

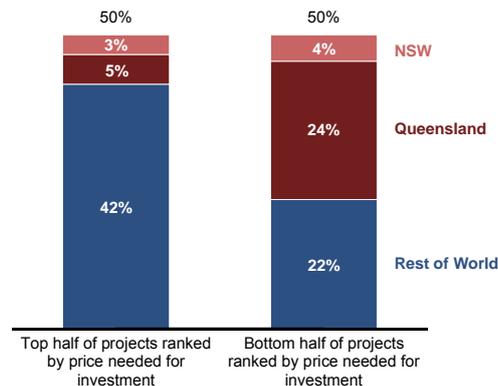
The cost pressures facing new coal mine investment is demonstrated at Chart Two. Measured by the price needed for profitable investment, recent analysis has demonstrated that of the top half of economic thermal coal developments, Queensland would constitute only 5% of that capacity if projects were developed on economic criteria alone.

<sup>44</sup> Port Jackson Partners *Regaining our competitive edge in minerals resources* Minerals Week Presentation (30 May 2012) 6 available at [http://www.minerals.org.au/file\\_upload/files/presentations/120530\\_MCA\\_presentation\\_FINAL.pdf](http://www.minerals.org.au/file_upload/files/presentations/120530_MCA_presentation_FINAL.pdf) accessed on 9 October 2013.

**Chart Two**<sup>45</sup>

Measured by the price needed for profitable investment, Queensland projects are almost exclusively in the least attractive half of known projects

**BREAKEVEN PRICE OF AUSTRALIAN THERMAL COAL PROJECTS**  
Share of proposed capacity, percent



Source: Wood Mackenzie; ABARE; PJPL analysis

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Port Jackson Partners

The economic consequences of a slowdown in new coal investment would be significant for Queensland's economy. QRC estimates that in 2011-12 the Queensland coal sector exported 165 million tonnes of coal at a value of almost \$22 billion<sup>46</sup> and paid \$2.4 billion in royalties to the State Government<sup>47</sup>. The coal mining industry employed ~30,000 workers<sup>48</sup> and the QRC estimates that it contributed \$19 billion to the Queensland economy through goods and services purchased (Opex and Capex) and employees' salaries.

The QRC remains concerned about the lack of new coal in the state projects reaching financial close. In order to sustain royalties, jobs and income levels the Queensland coal industry must ensure it does not reduce activity levels and ideally continues to expand. Ensuring that access charges are certain and sustainable is an important part of achieving that goal.

In summary, costs including access charges are an important determinant of the global competitiveness of the Queensland Coal industry. Competitive access charges are in the public interest and in the interests of access seekers.

### 4.3 Existing safeguards against monopoly power should not be relaxed

Access seekers do not have countervailing power and cannot effectively police ring-fencing or easily reach commercial agreements without the threat of a clearly defined and

<sup>45</sup> Ibid.

<sup>46</sup> IHS McCloskey statistics.

<sup>47</sup> Office of State Revenue, *Revenue statistics* (24 April 2013) available at <https://www.osr.qld.gov.au/royalties/statistics.shtml> accessed on 4 October 2013.

<sup>48</sup> Department of Natural Resources and Mines *Quarterly Coal Statistics* (December 2012) available at [http://mines.industry.qld.gov.au/assets/coal-stats-pdf/qrl\\_0412.pdf](http://mines.industry.qld.gov.au/assets/coal-stats-pdf/qrl_0412.pdf) accessed on 9 October 2013 2.

effective dispute resolution process. This is particularly the case in an environment where Aurizon Network is increasingly interested in focussing its resources on activities where it can earn above-regulated returns.

It is widely recognised that monopoly power concerns are greatest where the monopoly service provider is vertically integrated. Despite this, UT4 proposes to relax the ring-fencing obligations. For example, it is proposed that access seekers will no longer be able to lodge complaints regarding Aurizon Network's compliance with its ring-fencing obligations (or audit the handling of those complaints). If approved, this proposal would remove valuable scrutiny and has the potential to significantly undermine ring-fencing compliance.

Strong ring-fencing obligations are a fundamental part of any successful access regime applying to vertical integrated companies. Now is not the time to relax the ring-fencing requirements. Indeed, now is the time to focus even more carefully on ring-fencing. Aurizon Network is increasingly seeking to maximise returns to its new private owners, as it acknowledges in the supporting materials to UT4<sup>49</sup>. In this environment, Aurizon Network has an increased incentive to inappropriately take advantage of vertical integration. As noted recently by Asciano, inadequate ring fencing can result in:

‘discriminatory operational processes, discriminatory pricing (including cost shifting and cross subsidies) and discriminatory information provision to benefit their [Aurizon Network's] related parties’<sup>50</sup>.

Aurizon Network's focus in recent years has increasingly shifted towards areas where it can earn above-regulated returns. While Aurizon Network has appeared reluctant to progress negotiations for investment in its regulated business, it has showed no such reluctance about entering into arrangements which provide for it to earn above-regulated returns. For example, Aurizon Network has entered into a joint venture with GVK to provide unregulated below rail infrastructure to the Galilee Basin<sup>51</sup> and, after much delay, finalised GAPE and WIRP which also provides for Aurizon Network to earn a return above the regulated rate<sup>52</sup>.

A well understood and clear negotiation framework, supported by an effective dispute resolution procedure, is a vital element of a successful access regime. The access undertaking needs to contain detailed provisions to deal with the basic elements of seeking access but, as the NCC noted when considering the application to certify the Queensland rail access regime, there is also a ‘need for an independent arbitration mechanism to complement and encourage genuine negotiations’<sup>53</sup>.

UT4 proposes to narrow the scope of the dispute resolution procedure. Rather than applying to all aspects of the undertaking, the UT4 dispute resolution procedure is limited to matters where UT4 expressly requires use of the dispute resolution procedure. UT4 also proposes to limit the dispute procedure by altering the definition of ‘access seeker’ to mean only those parties who have completed a valid access application. This prevents other parties with a legitimate interest in obtaining access from being able to rely on (or even raise the prospect of using) the dispute resolution procedure to redress any concerns encountered when dealing with a monopoly service provider.

<sup>49</sup> Aurizon Network Explanatory Materials *2013 Draft access undertaking Volume 2: The 2013 Undertaking Proposal* (30 April 2013) 22.

<sup>50</sup> Asciano Submission at 7.

<sup>51</sup> Aurizon Network, *ASX Announcement – Aurizon and GVK Hancock proposed development of Galilee Basin rail and port infrastructure* (11 March 2013).

<sup>52</sup> L Hockridge and K Neate, *Interim Results 2013* (20 February 2013) 37.

<sup>53</sup> NCC *Queensland Rail Access Regime Application for certification under s 44M of the Trade Practices Act 1974 Final Recommendation* (22 November 2010) 50.

Stability and consistency of regulatory outcomes is a key factor affecting investment decisions. This was acknowledged by the ACCC Chairman, Rod Sims, who compared the task of a regulator to administering a long-term contract; with a focus on price stability and making sure prices reflect long-run costs<sup>54</sup>. Coal miners have invested significant capital expenditure in reliance on a stable and predictable regulatory environment. Introducing greater 'flexibility' into the access process by shifting the focus towards commercial negotiations will significantly affect coal miners, who are already fighting hard to compete in global markets. The delays that experience suggests would likely follow from such a shift would mark a significant change to the way the CQCN has been regulated and bring increased uncertainty to access seekers.

The risk involved when making significant long term investments increases significantly where a regulatory regime is constantly changing. Substantial changes to the regulatory framework are likely to have the effect of chilling or delaying efficient investment, which is directly contrary to the objects of Part 5 of the QCA Act. The High Court noted this risk in the *East Australian Pipeline* case stating that 'the greater the degree of uncertainty and unpredictability in the regulatory process, the greater will be the perceived risk of investment'<sup>55</sup>.

#### 4.4 It is not appropriate to fundamentally change the regime

In the absence of genuine countervailing power, it is not appropriate to approve UT4 given that it proposes a fundamental shift in the negotiating balance in favour of Aurizon Network.

To do so, would not further the object of the Queensland access regime, would not be in the interests of access seekers, is not in the public interest and is not in the legitimate business interests of Aurizon Network.

While it is legitimate for Aurizon Network to want to earn a reasonable return on its efficient investments, it can do so without fundamentally altering the balance of power and weakening mechanisms that have been put in place to try to limit the exercise of monopoly power. Aurizon Network is entitled to earn returns that are commensurate with running a regulated business but it is not entitled to have its interests taken into account to the exclusion of all other interests.

The object of the access regime is to promote efficiency and competition. The underlying objective of the regime is not affected by Aurizon Network having private investors who may be more interested in seeking above-regulated returns. The High Court has previously stated that where an asset was subject to regulation at the time of privatisation, investors are to be considered to have accepted the constraints that regulation places on their commercial interest as part of the 'bundle of rights' that they acquired<sup>56</sup>. This is particularly the case for Aurizon Network because the information provided to potential investors at the time of the IPO of Aurizon Holdings Limited clearly explained that Aurizon Network was a regulated business, with tariffs and other matters subject to approval by the QCA.

There are lots of regulated businesses that are run by private companies. They understand the nature of the environment in which they operate and recognise, and invest on the basis, that the underlying rationale for access regulation may limit their returns to what is required to promote efficiency and competition.

<sup>54</sup> Rod Sims *Infrastructure: why, when and how we regulate* speech to SMART Facility, University of Wollongong (23 February 2012) 3.

<sup>55</sup> *East Australian Pipeline Pty Limited v Australian Competition and Consumer Commission* (2007) 233 CLR 229 at 243.

<sup>56</sup> *Telstra Corporation Limited v The Commonwealth* [2008] HCA 7.

Compelling evidence would be required before making significant changes to the existing regime. Any suggestion that it is appropriate to relax the undertaking, dilute the dispute resolution procedures or weaken the ring-fencing mechanisms in the manner that UT4 does needs to be treated with the utmost caution.

## 5 Conclusion

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The CQCN is a critical piece of infrastructure. It has been regulated since 1997 and the first undertaking was approved in 2001. This consistently-applied approach to the regulation of rail infrastructure in Queensland should not be altered without careful consideration and compelling evidence that the very real concerns about misuse of monopoly power can be managed. In the absence of real evidence of countervailing buyer power, any proposals to fundamentally alter the mechanisms in the undertaking designed to protect access seekers (such as requirements in relation to access conditions, expansion obligations, dispute resolution and ring-fencing) should be treated with the upmost caution.

## Part 2 – Intent and Scope

### 1 Overview

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This part of the submission outlines the QRC’s position in relation to Aurizon Network’s obligations with respect to the Intent and Scope provisions under UT4, as captured in UT4 Part 2 (**Part 2**).

In summary, the QRC proposes the following key amendments to the Intent and Scope framework:

- 1 The broadening of the scope of UT4 to include, in addition to access rights, other matters addressed in the Undertaking. Restricting the scope of UT4 to access rights only unreasonably restricts the dispute resolution mechanisms available to parties with respect to ancillary matters which effectively fall within the scope of the Undertaking. The current Scope provision in UT4 misrepresents the true scope of the subject matter of the Undertaking.
- 2 The reinstatement of an objective standard, specifically ‘reasonable terms and conditions’, as contained in UT3 with respect to electricity supply. The QRC seeks to maintain Aurizon Network’s obligation to supply electricity to access holders on reasonable terms and conditions. The QRC does not support the relaxation of Aurizon Network’s electricity supply obligations as contemplated by UT4;
- 3 The inclusion of a dispute resolution mechanism for disputes arising in respect of electricity supply, as provided in UT3. The QRC seeks to maintain dispute resolution mechanisms in respect of electricity supply and does not support the removal of electricity supply dispute resolution mechanisms as contemplated by UT4;
- 4 The inclusion of a definition of Associated Services (including RIM and train control, Level and other crossing services, Land leases and Design and Scope and Standard Reviews) which identifies ancillary services for which it is only practicable for access holders to engage Aurizon Network. The QRC supports the inclusion of Associated Services in the Undertaking and an obligation upon Aurizon Network to perform these services upon request by access holders and to not unreasonably delay the performance of the such services.

The mark-up of Part 2 which reflects the amendments proposed by the QRC are set out separately in the mark-up document titled “Part 2 – Scope and intent” (**Mark-up**). It should be noted that the Mark-up does not address the QRC’s comments about ‘Associated Services’ (which are solely addressed in section 3 of this submission).

### 2 Electricity supply

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This section clarifies the QRC’s position in relation to certain aspects of Aurizon Network’s UT4 electricity supply obligations but does not seek to limit the QRC’s Mark-up.

## 2.1 Reasonable terms and conditions

The obligation for Aurizon Network to provide electricity to access holders in UT3 has been relaxed in UT4. UT3 imposes an obligation upon Aurizon Network, to the extent Aurizon Network sells or supplies a related operator with electric energy in connection with access, to not refuse to sell or supply electric energy to another access seeker or access holder. The obligation is not absolute, as Aurizon is not required to sell or supply on unreasonable or uncommercial terms.

UT4 only requires Aurizon Network to agree to supply electricity on terms *“acceptable to it and which are reasonable having regard to the terms on which that electric energy could be supplied by alternative sources.”*

The QRC opposes the relaxation of the obligation to supply electric energy under UT4. The QRC supports the inclusion of the objective standard of ‘reasonable terms and conditions’ in order to prevent the arbitrary withholding of electric energy supply.

The QRC also believes there must be appropriate transitional arrangements for existing operators should Aurizon Network assert that those operators’ existing terms are no longer acceptable. In such circumstances Aurizon Network should be obliged to continue to supply electric energy under the terms that existed prior to the approval of UT4 until revised terms are agreed or resolved through dispute resolution.

## 2.2 Dispute resolution

Under UT3, disputes in relation to the negotiation of electric energy supply agreements could be referred to dispute under that undertaking. There is no such dispute right under UT4.

If there is no ability to dispute a wrongful failure by Aurizon Network to enter into an electric energy supply agreement, there is no effective obligation on Aurizon Network. It would be most expedient if a failure by Aurizon Network to comply with its obligation in relation to electric energy supply could be referred to an expert for determination.

## 3 Associated Services

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It is the QRC’s submission that for some services associated with access rights, Aurizon Network is the only practicable service provider available to access holders and access seekers (**Associated Services**). For Associated Services, access seekers and access holders face a situation in which the engagement of another service provider would result in significant inefficiencies or the engagement of an alternative is not possible.

### 3.1 Meaning of Associated Services

The access undertaking should include a definition of Associated Services which identifies ancillary matters that it is practicable only to engage Aurizon Network for.

The Associated Services should be exhaustively defined.

Matters to be included in the definition of Associated Services are:

- (a) **RIM and train control**  
RIM and train control services for rail spurs.
- (b) **Level and other crossings**

Level and other crossing services, including maintenance and upgrades to existing level crossings and the design and construction of new level crossings.

**(c) Land leases**

Leasing to Customers of corridor land and land owned by Aurizon Network, which land sits within balloon loops either at a mine site or at a port unloading terminal.

**(d) Design, Scope and Standard Reviews**

To the extent that Aurizon Network in its capacity as RIM or land owner/lessor/lessee requires infrastructure connecting to the network to comply with minimum standards, the provision of such review and comment services.

### **3.2 Payment for associated services**

The actual prudent costs of performing Associated Services, plus a margin approved by the QCA, should be reimbursed by the relevant access holder.

The basis upon which the QCA approves any margin will be by reference to the degree of risk borne by Aurizon Network under the relevant service agreement, having regard to market practices.

Where the parties cannot agree on the prudence of the costs of Associated Services, prudence should be determined by the QCA or if the QCA does not have jurisdiction, an expert.

### **3.3 Who can request Associated Services**

Any access holder or access seeker (ie to cover prospective negotiation for RIM or design review services etc) (or where access is held by an operator, the customer) may require Associated Services to be performed by Aurizon Network. Aurizon Network may not unreasonably delay performance of the Associated Services.

### **3.4 On what terms are the Associated Services to be performed?**

The terms on which the Associated Services are to be performed should be agreed between the parties. If the parties cannot agree the terms of performance, the terms should be determined by an expert having regard to similar or equivalent type services.

# Part 3 – Ring-fencing and Protections against conflicts

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to the ringfencing principles, protections against conflicts and related requirements in UT4, as captured in UT4 Part 3 (**Part 3**).

This submission is structured in a similar way to Part 3.

Given Aurizon’s involvement in above rail, ports and new (non-Central Queensland) below rail development, Part 3 should go beyond ring-fencing so as to address the numerous conflicts of interest (**Conflict Protections**). For example, UT4 has had sufficient input from Aurizon Corporate. It is clear that in drafting UT4 Aurizon has had regard to the interests of its above rail business (see for example our submissions on Schedule F). It is patently unfair that Aurizon can set the undertaking up so as to benefit its above rail business. There is nothing in Aurizon’s version of UT4 that would prevent this occurring in the future.

The QRC is also concerned by Aurizon’s public and private statements about the nature of its integrated business. For example, in its recent investor presentation, Aurizon stated that one of its 4 key operational objectives was “leveraging an integrated approach to the business”. Indeed, the experience of industry is that Aurizon Network is anything but separated from the remainder of the Aurizon Group.

The QRC considers that Part 3 needs to be wholly re-written. Section 3.1 of the QRC mark-ups contains the QRC’s proposed re-draft (**Re-draft**).

In summary, the QRC proposes the following key changes to the UT4 conflicts framework:

- 1 An expanded and more balanced approach to the objective or “purpose” of Part 3;
- 2 A more comprehensive coverage of protection against conflicts, including the incorporation of arrangements for the separation of Aurizon Network’s operations concerning the regulated access service (and the costs, revenues and decision-making associated with the regulated access service), both internally and from operations concerning any other commercial activity;
- 3 An expansion of the general principles of non-discrimination;
- 4 The reinstatement of the provisions in UT3 designed to ensure that Aurizon Network remains responsible for all rail transport infrastructure;
- 5 Heightened obligations for Aurizon Network to perform access-related functions and maintain management separation;
- 6 A new confidential information regime, including the broadening of the scope of confidential information beyond merely commercially sensitive information and increased minimum training requirements;
- 7 A more extensive complaints handling process; and
- 8 The reinstatement of annual compliance auditing for Aurizon Network’s Part 3 obligations.

## 2 Section A – General provisions

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### 2.1 Preamble

The QRC generally agrees that the “Preamble” should cover the matters currently listed in UT4. However, the QRC considers that the “purpose” provisions of Part 3 are too limited. Aurizon Network’s proposal is that the purpose of Part 3 is merely to “aid Aurizon Network’s compliance with the statutory obligations”. The QRC considers this to be only part of the purpose. In any case, section 137 of the QCA Act does not limit the purpose in this manner. In the QRC’s view, the objective or “purpose” of Part 3 is broader and, while it may include aiding Aurizon Network’s compliance with section 137, the QRC considers it should be expressed in more balanced terms as is discussed in section 2.2 below.

### 2.2 Purpose and coverage of protection against conflicts

The purpose of conflict protection generally is to deliver fair market conditions to users (and potential users) and providers of services by removing or reducing the opportunity for anti-competitive behaviour where an entity provides both a monopoly service as well as services in competitive markets. There may also be potential for this type of behaviour where the entity which provides the monopoly service is part of a wider corporate group which provides services in competitive markets, whether or not it is the entity itself which provides the competitive services. Conflict protection is also important in these circumstances, otherwise the promotion of competition in such markets (being one of the factors to be considered by the QCA in determining whether to approve an access undertaking) may be thwarted.

As well as application of principles of non-discrimination, conflict protection involves the identification and separation of an entity’s operations concerning a monopoly service from its other operations concerning another commercial activity. This is specifically recognised in the QCA Act as a matter which may be included in an access undertaking and the most recent amendments to the *Infrastructure Act 1994*.

In UT4, Aurizon Network has sought to rely on the legal separation of Aurizon Network from its parent entity as the basis for significantly reducing its ringfencing obligations. The QRC considers that Aurizon Network’s approach:

- artificially seeks to focus solely on the legal form of the Aurizon Group’s structure while ignoring the economic substance of the Aurizon Group’s arrangements;
- is contrary to the longstanding principles of competition and economic regulators recognising the reality of vertically integrated corporate groups and treating such corporate groups as a single entity for the purposes of assessing the likely impacts of their conduct on competition; and
- relies on an unreasonably narrow interpretation of section 137 of the QCA Act.

In the QRC’s view, the interwoven nature of the operations of the Aurizon Group means that the potential for anti-competitive behaviour still exists and must be addressed in UT4. In particular, the QRC considers that there must be identification of, and arrangements for the separation of, Aurizon Network’s operations concerning the regulated access service (and the costs, revenues and decision-making associated with the regulated access service) from operations concerning any other commercial activity. These other commercial activities must include but are not limited to, any above rail services (Aurizon Operations), any port services (Aurizon Terminal) and Queensland rail infrastructure development outside of the Central Queensland Rail Network (**CQRN**) but within the Aurizon Group. Aurizon Network’s proposal is to limit the separation to only some of the operations concerning the regulated access service (described as “Core Access-related

Functions”). This is narrower than the approach approved in UT3 and the QRC does not consider there to be any justifiable basis for such a change in UT4.

All Aurizon Network’s operations concerning the regulated access service must also be separated. The QRC has proposed a definition of “**Access-related Functions**” in its Re-draft which is intended to cover the “primary function” as proposed by Aurizon Network, the performance of all other “Below Rail Services”, and other specific matters included in the definition. Contrary to Aurizon Network’s position, the QRC considers that the definition of Access-related Functions should be expressed to include all “Below Rail Services” unless specifically excluded to ensure increased regulation of Aurizon Network. Even with this broad scope, the QRC suggests that certain essential functions be expressly listed in UT4, including:

- (a) Any changes to UT4, any future access undertaking as well as any pro forma or standard documentation contemplated or required by UT4 and any amendments to any of these;
- (b) Reporting under and performing UT4;
- (c) Receiving and dealing with access applications;
- (d) Negotiating agreements for expansions (including funding arrangements for expansions) and studies for expansions;
- (e) Negotiating an access agreement, a user funding agreement, a rail connection agreement and any related agreements;
- (f) Train control, marshalling yards, electric infrastructure, access to land; and
- (g) Performing and enforcing access agreements, agreements for studies for expansions, agreements for expansions and other agreements to which Aurizon is a party as contemplated UT4.

In the QRC’s view, Aurizon Network’s Conflict Protections should relate to all Access-related Functions, including both Aurizon Network’s specific functional responsibilities (discussed further in section 3) and the protection of information (discussed further in section 5).

## 2.3 General principles of non-discrimination

The QRC agrees with the non-discrimination principles set out by Aurizon Network in UT4, subject to the inclusion of the following additional matters:

- (a) The non-discrimination principles should not only refer to “Related Operators”, but also to Aurizon Network itself and any other related party. This is consistent with the QCA Act’s access provisions;
- (b) The non-discrimination principles should be extended to cover any existing or future interests of the Aurizon Group in:
  - (1) any ports in Queensland; and
  - (2) any railways in Queensland (other than the CQRN),
 and for the purposes of applying the non-discrimination principles, an entity should be deemed to be “related” if it represents a port or railway in Queensland (other than the CQRN) in which any member of the Aurizon Group directly or indirectly holds an interest; and
- (c) The compliance monitoring principles discussed in section 7 of this submission are adopted to ensure transparency in compliance.

These concepts have been included in the QRC’s Re-draft.

## 2.4 Ultimate Holding Company Support Deed

Under UT4, the ultimate holding company must execute a deed in favour of the QCA agreeing to ensure that it and all other related parties of Aurizon Network support the Conflict Protections. In particular, the Ultimate Holding Company Support Deed must state that the Aurizon Group is to take such actions as are necessary to enable Aurizon Network to comply with its Conflict Protections where it is reliant on a related party in order to do so.

In the QRC's view, the form of the deed proposed by Aurizon Network in UT4 is too narrow in the following respects:

- In respect of procuring compliance it is limited to ensuring no contrary direction or request, with no requirement to provide positive assistance as required (as the current undertaking requires);
- It should include an undertaking to ensure that each related party complies with provisions regarding protected information it receives as if it were Aurizon Network; and
- The undertakings as to management of Aurizon Network in the deed should also include the additional matters discussed in section 4 below.

The QRC further considers that Aurizon Network should include restrictions on the actions of related parties should they incorrectly receive confidential information. Such restrictions could either be incorporated into UT4 directly, the Ultimate Holding Company Support Deed or individual agreements with the relevant related party. Regardless of the means of incorporation, the final requirements should be publicised for transparency and auditing purposes.

While the Ultimate Holding Company Support Deed is an important component of the ringfencing framework, Aurizon Network's obligations for dealing with confidential information should not be reliant on it. The QRC considers that Aurizon Network's Conflict Protections should all be expressly contained within the Access Undertaking for the regulatory certainty of access holders and access seekers.

Section 3.2 of the QRC's mark-ups contains the QRC's mark-up of the Ultimate Holding Company Support Deed.

## 2.5 Standard form confidentiality agreement

A standard form confidentiality agreement should be retained in UT4. The inclusion of a template confidentiality agreement will give access seekers confidence in respect of the sensitive business information they are required to disclose and will generally reduce extensive initial disputes over the content of confidentiality deeds. It will also allow access seekers to have a detailed understanding of exactly how their information will be dealt with after it is in the possession of Aurizon Network, particularly how it will be distributed to related parties.

Section 3.3 of the QRC's mark-ups contains the QRC's proposed standard form confidentiality agreement.

## 2.6 Responsibility for rail infrastructure

UT3 contains a number of provisions designed to ensure that Aurizon Network remains responsible, as a stand-alone access provider, for all rail transport infrastructure. Access to that infrastructure forms part of the declared service (currently designated as 'red track' in the line diagrams). In addition, the UT3 provisions provide:

- a clear prohibition on the assignment or transfer of ownership of such infrastructure to a related party within the Aurizon Group or removing existing infrastructure (except in special circumstances) without the QCA's approval; and
- a clear avenue for access seekers or access holders to challenge the allocation of ownership of rail transport infrastructure where they are reasonably of the opinion that Aurizon Network does not have responsibility for rail transport infrastructure that forms part of the declared service (and refer the matter to the dispute regime where dissatisfied with the result of Aurizon Network's review of the allocation).

In UT4, Aurizon Network has indicated that it considers that these provisions are no longer required due to the scope of the declaration allegedly being clearer and the legal ownership of the below rail track now being given to Aurizon Network under the infrastructure leasing arrangements with the State.

The QRC does not accept Aurizon Network's position. The declaration (per section 250 of the QCA Act) continues to rely on the concept of 'rail transport infrastructure' and therefore the ambiguities that previously existed under UT3 will continue to remain. Further, while the QRC does not have access to the infrastructure lease, it considers it unlikely that the lease would describe the rail transport infrastructure with sufficient specificity to make it possible to determine whether existing (or future) rail transport infrastructure should be categorised as 'red track' or 'blue track'.

Given that the scope of UT4 (like UT3) is, in practice, effectively defined by reference to the line diagrams, the QRC considers it critical that:

- (a) the 'red track' covers all of the rail transport infrastructure within the scope of the declared service;
- (b) the QCA maintains independent oversight of changes to the line diagrams; and
- (c) there is opportunity to seek conversion of incorrectly allocated 'blue track' to 'red track'.

In addition, due to the control that the ultimate holding company will have over the initial allocation of ownership and responsibility or subsequent intra-group transfers, the QRC also considers it appropriate for the Ultimate Holding Company Support Deed to impose a positive obligation on the ultimate holding company to ensure that rail transport infrastructure which is within the scope of the declared service is only ever owned by Aurizon Network.

## 3 Section B – Aurizon Network's specific functional responsibilities

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### 3.1 Functions of Aurizon Network

While the QRC agrees that it is appropriate to describe the primary function much as is proposed by Aurizon Network, the defined term should be "Access-related Functions" (as defined in section 2.2 above), not the more limited concept of "Core Access-related Functions" proposed in UT4.

### 3.2 Obligation of Aurizon Network to perform Access-related Functions

The QRC considers that a more extensive regime is required in UT4 for ensuring that only Aurizon Network performs Access-related Functions. The QRC’s Re-draft includes the following additional concepts to those currently proposed in UT4:

- A prohibition on Aurizon Network from transferring, delegating or subcontracting any Access-related Function to a related party that has an interest in a port or railway in Queensland (other than the CQRN) or an associate of such a party;
- A prohibition on Aurizon Network from transferring, subcontracting or delegating any functions, services or work to a related party except for those listed (to be resolved by the QCA) in UT4; and
- A prohibition on Aurizon Network from:
  - (1) undertaking any above rail services;
  - (2) the operation or marketing of train services on the rail infrastructure except as proposed by Aurizon Network, for the purpose of performing an Access-related Function or the provision of services in respect of private infrastructure; or
  - (3) undertaking any port services or holding any interest in any port in Queensland;
  - (4) Undertaking any above rail services or “Below Rail Services” in respect of, or holding any interest in, any railway other than CQRN.

### 3.3 Staff

The QRC also considers it appropriate for UT4 to impose additional restrictions around the functions Aurizon Network’s staff can undertake. The QRC’s Re-draft includes the following additional concepts to those currently proposed in UT4:

- Aurizon Network must ensure that “Access-related Functions” are only performed by staff employed by Aurizon Network except where otherwise approved by the QCA; and
- Secondments between Aurizon Network and related parties should be expressly prohibited, even where such a secondment would be in the course of an employee’s duties, subject to specific secondments approved by the QCA.

### 3.4 Accounting

The QRC agrees with the accounting framework proposed by Aurizon Network. However, given Aurizon’s increasingly varied interests in upstream and downstream markets, it is likely there will need to be consequential amendments to the QCA-approved costing manual in order to properly regulate the financial and accounting separation of the below rail business.

## 4 Section C – Management of Aurizon Network

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The QRC considers that the requirements of UT4 Section C should be extended to regulate:

- (a) Aurizon Network’s management separation from related operators and associated port/rail entities; and

- (b) the appointment of board members for Aurizon Network.

The QRC's Re-draft reflects these two key concepts.

The QRC is particularly concerned about ensuring the independence of Aurizon Network's board and board members. The QRC understands that the same individual holds positions as Managing Director of the ultimate holding company, and as a director of Aurizon Operations, Aurizon Property and Aurizon Terminal. The effects of this cross-directorship could undermine the ringfencing principles. Aurizon Network's board should not include directors of related parties as their corporate duties to each company may conflict with the principles of regulation.

## 5 Section D - Protection of information

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### 5.1 Definition of Confidential Information

The definition of "Protected Information" proposed by Aurizon Network is, in broad terms, limited to information which is disclosed to Aurizon Network by a third party and which is commercially confidential to the third party. In the QRC's view, "Protected Information" (as defined) should be considered to be a subgroup of what should properly constitute "Confidential Information". The QRC does not agree with the narrowing of the categories of confidential information protected by the ringfencing regime to one of only "Protected Information" as is presently the case in UT4.

In addition to "Protected Information", the QRC considers that the definition of "Confidential Information" should include other communications, documents and information (whether electronic or tangible) otherwise held, obtained or created by Aurizon Network regarding or relating to any Access-related Functions which by their nature are confidential (for example, information relating to any of the specific matters referred to in paragraphs 2.2(a)-2.2(g) above).

Given the conflicts in the Aurizon Group, confidential information extends beyond purely commercially sensitive documents. Access holders and access seekers should not be required to consider whether each piece of information provided to Aurizon Network will be protected from distribution to related parties. Such a system may result in access holders and/or access seekers engaging in behaviour detrimental to negotiations, including:

- (a) not producing information to Aurizon Network due to uncertainty as to whether it will be disclosed to related parties; or
- (b) disclosing all material to Aurizon Network with an express designation of "protected information" in order to ensure that no information can be transferred by Aurizon Network.

Further, such a system also makes the ringfencing arrangements more complicated for Aurizon Network to administer.

### 5.2 Security of Confidential Information

The QRC considers that Aurizon Network's overarching commitment to information security in UT4 (captured by of UT4 clauses 3.14 and 3.21) should be extended so that:

- (a) Confidential Information (as defined by the QRC) is kept confidential and secure;
- (b) adequate security measures (physical, electronic or otherwise) are in place to ensure that only persons as and to the extent permitted by UT4 have access to

Protected Information in Aurizon Network’s possession or control (whether in electronic or tangible form); and

- (c) Confidential Information (as defined by the QRC) is not used or disclosed to any person except as expressly permitted by UT4.

Aurizon Network should also be obliged to maintain a record of which staff members from related parties have accessed Aurizon Network premises that contain Confidential Information (as defined by the QRC) and should record the reason why for compliance auditing purposes.

### 5.3 Permitted use and disclosure

The QRC proposes that the use and disclosure of Confidential Information (as defined by the QRC) be governed in UT4 based on the following principles:

- Employees and officers of Aurizon Network may access and use Confidential Information (as defined by the QRC) to the extent necessary to discharge their duties concerning Access-related Functions but only on a need-to-know basis.
- Confidential Information (as defined by the QRC) must only be used for the purpose for which it was disclosed to Aurizon Network and only to the extent necessary for that purpose.
- Aurizon Network may only disclose Confidential Information (as defined by the QRC) :
  - (1) to the extent required by shareholder reports, provided that persons that are permitted to review such reports are confined to specified management of the ultimate holding company;
  - (2) to a subcontractor to the extent necessary to enable subcontractors to perform the relevant subcontract, on a confidential basis;
  - (3) to a third party that is advising or otherwise working for Aurizon Network in respect of Access-related Functions to the extent Aurizon Network reasonably considers such disclosure necessary for the relevant advice or performance of the work, on a confidential basis and provided the third party is not also advising or otherwise working for a related party that is a related operator or has an interest in a port in Queensland or a railway in Queensland other than the CQRN (**Excluded Party**); or
  - (4) otherwise with the prior written consent of the owner of the Confidential Information (as defined by the QRC) .
- Without limitation to any other provision in UT4:
  - (1) Confidential Information (as defined by the QRC) must not be used or disclosed where the likely result will be that a excluded party obtains an unfair commercial advantage; and
  - (2) disclosure may not be made to the Marketing Division of any related operator without the prior written consent of the relevant third party.
- Aggregation of information for disclosure should only be allowed where it has been expressly permitted by access holders/seekers and discusses trends or management of the CQRN as a whole.

## 5.4 Process for permitted disclosure of Confidential Information

Where disclosure of Confidential Information (as defined by the QRC) is permitted (as contemplated by paragraph 5.3), the QRC considers it important that Aurizon Network ensure that:

- (a) Confidential Information (as defined by the QRC) is clearly identified as such;
- (b) The recipient has signed a declaration of awareness and understanding of the obligations regarding the Confidential Information (as defined by the QRC) and, if not covered by the Ultimate Holding Company Support Deed, enters into a confidentiality undertaking; and
- (c) The recipient has been advised of the basis on which access has been provided and, if relevant, a date for review of entitlement to access, is recorded in the confidential information register.

These requirements must apply whether or not the recipient is within Aurizon Network, a related party or any other person.

## 5.5 Confidential Information Register

The Confidential Information Register (or the “Protected Information Register” as defined in UT4) proposed by Aurizon Network should apply to Confidential Information (as defined by the QRC in its Re-draft) and contain details relating to all disclosures, whether within Aurizon Network, to other related parties or third parties, as well as the other information contemplated in paragraph 5.4(c) above.

Aurizon Network must be able to provide written reasons for any disclosure when a complaint is lodged.

## 5.6 Training

In the QRC’s view, the mandatory minimum training requirements supporting the promotion of awareness of Aurizon Network’s Conflict Protections are too narrow. At a very minimum, Aurizon (in particular Aurizon Network, Aurizon Holdings, Aurizon Operations and Aurizon Terminal) should be obliged to carry out initial training for all staff on the application of conflict protections at the commencement of UT4. In addition, the QRC has proposed in its Re-draft that Aurizon Network be obliged to carry out more detailed training sessions for Aurizon Network staff who perform Access-related Functions or have access to Confidential Information (as defined by the QRC) .

# 6 Section E – Complaints and waiver

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## 6.1 Complaints

The QRC Re-draft proposes a more extensive complaint process than has been included in UT4. The QRC’s key amendments include:

- An expansion of the scope of the complaints regime to allow third party access seekers, access holders and train operators to lodge a complaint where there is an alleged breach of the Ultimate Holding Company Support Deed or an individual confidentiality agreement. Without this form of complaint, stakeholders will only have recourse to litigation to rectify breaches of these agreements;

- The inclusion of precise timelines within the complaint handling process. Similar to other regulatory complaint handling, the QRC considers it important that Aurizon Network have a specific time to respond to a correctly-lodged complaint;
- The inclusion of a mechanism for a complainant to seek an audit of Aurizon Network's compliance with the Conflict Protections if the complainant is not satisfied with the outcome of Aurizon Network's investigation into the complaint and subject to the QCA deeming an audit appropriate; and
- The inclusion of an obligation for Aurizon Network to report on complaint handling time in its annual compliance report.

In the QRC's view, these amendments will ensure a higher degree of accountability for Aurizon Network in performing its Conflict Protections.

## 6.2 Waiver

In the QRC's view, Aurizon Network should not be allowed to seek a waiver of its Conflict Protections. Applying the concept of waiver to the Conflict Protections significantly reduces their importance in UT4, and suggests that in instances non-compliance is acceptable.

## 7 Compliance

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Aurizon Network's proposal in UT4 is that there be no provision for periodic checking or audit of compliance by Aurizon Network with the Conflict Protections unless there is a specific complaint. Without mandatory auditing, it is difficult to see how parties outside the Aurizon Group would be sufficiently informed to be able to identify a complaint.

To provide increased transparency and preserve access seeker and access holder confidence, the QRC considers an annual audit of Aurizon Network's compliance with Conflict Protections to be appropriate, as was the case in UT3. The QRC has reinstated the provisions of clause 3.7 of UT3 in its mark-up of UT4 Part 10 in keeping with Aurizon Network's approach of consolidating all UT4 reporting and auditing obligations in one part of UT4.

## Part 4 – Negotiation framework

### 1 Overview

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This part of the submission outlines the QRC's position in relation to the negotiation framework under UT4, as captured in UT4 Part 4 (**Part 4**).

In summary, the QRC proposes the following key amendments to the negotiation framework:

- 1 The inclusion of a mandatory, rather than optional, requirement for Aurizon Network to notify an access seeker that their access application is incomplete;
- 2 The inclusion of an acknowledgement that prior to and during the negotiation period, it is unlikely and unnecessary for an access seeker to hold all rights ancillary to the rail network access rights being sought. Rather, it should be sufficient for an access seeker to demonstrate a reasonable likelihood of utilising the access rights by the time the access rights are to commence on the basis of such rights;
- 3 The reinstatement of the ability of an access seeker to vary or revise its access application, except that an access seeker cannot request an increase in capacity, a shorter term of access, or any other change which substantially alters the nature of the access rights;
- 4 The reinstatement of the requirement for an indicative access proposal to provide detail on the initial access charge according to the pricing principles, and the inclusion of a requirement for an indicative access proposal to contain information on expansion planning;
- 5 The acknowledgement that the strict expiry date of an indicative access proposal does not apply where access is contingent on an expansion or customer specific branch line;
- 6 The removal of the ability for Aurizon Network to suspend negotiations with all operators where multiple access applications are received for the same access rights and no one operator is yet nominated by the customer. The QRC considers that Aurizon Network should facilitate the ability for operators to undergo a competitive tender with an end customer by continuing to negotiate with all operators;
- 7 The broadening of the requirement for a train operator to identify the relevant end user or customer and provide evidence of that end user or customer having nominated them as train operator. The QRC also considers there should be an express acknowledgement that a rail haulage operator may only apply for access, or hold access rights, where this is done for a specified customer.
- 8 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. The QRC considers Aurizon Network should be required to prepare a revised indicative access proposal, at the request of the access seeker, if either 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;
- 9 Making relevant tests under Part 4 objective tests, rather than a subjective test based on Aurizon Network's opinion; and

- 10 Removing 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.

The mark-up of Part 4 which reflects the amendments proposed by the QRC are set out separately in the mark-up document titled “Part 4 – Negotiation framework” (**Mark-up**).

## 2 Negotiation Framework

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This section clarifies the QRC’s position in relation to certain aspects of the negotiation framework but does not limit the QRC’s Mark-up.

### 2.1 Incomplete access application

The definition of access seeker has been adjusted under UT4 such that a person only becomes an access seeker once a fully complete access application (to the satisfaction of Aurizon Network) has been provided. Under UT4, the date of an access application is taken to be the date on which a fully completed access application has been received by Aurizon Network. It is only from that date that Aurizon Network’s obligation to provide an acknowledgement notice is triggered.

Because of the significance placed on the date a fully “complete” access application is received, the QRC considers it should be mandatory, rather than merely optional, for Aurizon Network to notify an access seeker that their access application is incomplete or not compliant. Aurizon Network should also be required to provide full details of the additional information required to render the application complete. This will allow for the expeditious and efficient completion of access applications and assist with progressing the negotiation of access rights in a timely manner.

### 2.2 Information requirements for an access application

The information requirements for an access application under UT4 are substantially similar to those under UT3, except for the inclusion of a requirement to provide information or evidence as to an access seeker’s ability to fully utilise the requested access rights by reference to a number factors. These factors include the ability to secure access to a port, existence of a rail haulage contract and other private infrastructure rights.

The QRC accepts that such factors may be relevant to Aurizon Network’s consideration of an access application. However, the current drafting fails to acknowledge that at the time an access application is made and during the negotiation period, it is unlikely that an access seeker will actually hold such ancillary contractual rights. An access seeker should not be prevented from seeking access rights solely because those ancillary contractual rights are not finalised at that early stage. The QRC considers that if an access seeker provides evidence of a reasonable likelihood of having the necessary ancillary contractual rights by the time that the access rights are to commence, this should suffice. There should also only be a requirement to provide any evidence or information in relation to such factors to the extent such evidence or information exists.

Further, Aurizon Network have specified four different items to be considered in determining whether the access seeker will be able to utilise access rights. The QRC have proposed a rationalisation of the list of those matters.

## 2.3 Revisions to an access application

Under UT3, if Aurizon Network had issued an acknowledgement notice but was yet to issue an indicative access proposal, the access seeker was permitted to review and vary its access application provided that it did not substantially alter the nature of the access rights sought. This ability to revise an access application was removed from UT4. Aurizon Network contends that removing this right will facilitate “*the timeliness of negotiations*”.

The QRC does not agree with this proposition. The time to progress an access application to an access agreement often takes at least 12 months, and progression of a mine study, and/or other planning progress during such time, can often result in changes. The QRC considers that removing the ability to revise an access application will force an access seeker to submit an entirely new application every time there is some change in information, no matter how small. The QRC considers that this will cause unnecessary delay and duplication in the negotiation process.

The QRC suggests that the ability of an access seeker to vary or revise its access application prior to the provision of an indicative access proposal be reinstated. Further, to prevent misuse of this provision, the clause should prohibit the request for an increase in capacity, request of a shorter term of access, or any other change which substantially alters the nature of the access rights sought. For example, the QRC believes it is reasonable for an access seeker to request to vary its access application in circumstances where:

- as a result of the further progression of a mine study, it becomes evident that less capacity will be required; or
- there is a change to the mine origin, provided that there is no change to capacity, the term of access or the specified destination.

The QRC also proposes that analogous adjustments be adopted in relation to an access seeker’s ability to review and revise the information contained in its access application after the issue of an indicative access proposal as well as during the negotiation period. However, where an access application is reviewed and revised by an access seeker after the issue of an indicative access proposal, Aurizon Network should be given the ability, if necessary, to review the indicative access proposal and issue a revised indicative access proposal.

## 2.4 Indicative access proposal

Aurizon Network has removed the obligation for the indicative access proposal to include an initial estimate of the access charge based on the pricing principles set out in Part 6 and for the indicative access proposal to specify certain detail as to how that charge was calculated. The QRC considers that the requirement to provide this detail should be reinstated in UT4.

Provision of the estimate access charges is critical to the conduct of mine feasibility studies, particularly where access charges represent an increasing proportion of FOB costs. The outcome of the pricing principles will also be an key consideration for mine feasibility studies in order to understand whether existing access charges are indicative or whether increased charges will apply, and to understand the risks of access charge changes under various scenarios.

The QRC also considers that where access is contingent on an expansion the indicative access proposal should provide information on expansion planning including an estimated time at which access is likely to be provided.

## 2.5 Notification of intent

UT3 provided that an access seeker could notify its intention to progress an access application on the basis of an indicative access proposal after the expiry of the indicative access proposal (but not more than six months after that date), on the provision that Aurizon Network could choose to review and revise the indicative access proposal. Under UT4 notification of intent to progress an access application must always be provided before the expiry of the indicative access proposal. Aurizon Network considers that this strict deadline incentivises parties to meet negotiation timeframes and lessens the chance of an indicative access proposal becoming out-dated.

The QRC agrees that a strict expiry date of an indicative access proposal should be adhered to where access is not contingent on an expansion or customer specific branch line. In such circumstances, it is reasonable that if an access seeker has not notified Aurizon Network of its intention to progress its access application by the date of expiry, then the access application and the indicative access proposal should be taken to have been withdrawn.

However, if access is dependent on an expansion or customer specific branch line, and the negotiation process has been suspended, then the expiry of the indicative access proposal should be suspended. For this reason, it is also important that the access seeker be given the right to request Aurizon Network to suspend the negotiation process, rather than Aurizon Network being afforded sole control over whether a suspension is affected.

## 2.6 Multiple applications for the same access

UT4 contains new provisions which govern the negotiation process where Aurizon Network receives multiple access applications for the same access rights. These provisions include Clause 4.7 (now Clause 4.8 under the QRC's mark-up).

Under that clause where Aurizon Network receives access applications from multiple operators, and a customer has not yet nominated one of those operators, Aurizon Network must provide an indicative access proposal to each operator. However, after an indicative access proposal has been provided, Aurizon Network may suspend negotiations until the customer nominates an operator.

The QRC considers that the ability to suspend negotiations in such circumstances should be removed. Rather, Aurizon Network should facilitate the ability for operators to undergo a competitive tender with an end customer by continuing to negotiate with all operators. This should be done on the understanding that only one maximum capacity application exists with the customer. This will allow an end customer to nominate the division of tonnes between the operators based on an operator's proposal following the tender process.

## 2.7 'Train Operators' (and rail haulage operators)

Under UT4, Aurizon Network has sought to clarify the way in which relevant provisions apply to a train operator. In particular, specific provisions have been included which identify a train operator's involvement in the negotiation process.

These provisions include a requirement under Clause 4.8 (now Clause 4.9, under the QCR's mark-up), for a train operator wishing to enter into a train operations agreement, to identify the relevant end user and provide evidence of that end user having nominated them as train operator. As currently drafted, the provision applies only where a train operator requests to contract with Aurizon Network under a train operations agreement. An end user is defined as a party to an end user agreement.

The QRC contends that the operation of this clause is unnecessarily restricted. The requirements under this provision should apply more broadly to also encompass rail haulage operators who contract with Aurizon Network under a standard access agreement (Operator). For this reason, the reference to “End User” in clause 4.8 (clause 4.9 in the QRC’s mark-up) should instead be a reference to “Customer”. The “Customer” being the person for whose benefit the access rights are ultimately obtained.

The QRC also considers that there should be an express prohibition on a rail haulage operator applying for access, or holding access rights, where this is not done for the benefit of a specified customer. To clarify, this would also mean that where a train operator ceases to hold access rights for a specified customer, those access rights should be subject to resumption (assuming that an alternative customer cannot be found).

## **2.8 Negotiations where capacity is not available**

In some circumstances, Aurizon Network may become unable to offer access under an indicative access proposal because of a reduction in available capacity or infrastructure enhancements later committed to by Aurizon Network. In those circumstances, under UT3, Aurizon Network was required to prepare a revised indicative access proposal, at the request of the access seeker, if either the remaining available capacity could satisfy part of the access rights sought, or the infrastructure enhancements could be altered. Under UT4, this requirement to offer a revised indicative access proposal has been removed in favour of a suggestion that Aurizon Network and the access seeker “discuss the matter with a view to agreeing alternative means of providing access rights”.

The QRC does not agree with this change. The QRC considers that the UT3 provision should be reinstated. The UT4 provision is too vague and fails to adequately protect the interests of an access seeker. The UT3 provision provides clarity around the way in which negotiations should proceed and the form of alternative access proposal that must be offered by Aurizon Network.

## **2.9 Cessation of negotiations**

Under UT4, Aurizon Network may cease negotiations by issuing a cessation notice on the basis of a number of listed circumstances. The current drafting of UT4 allows Aurizon Network to make a decision on the existence of such matters on the basis of its “reasonable opinion”.

To ensure a fair and transparent process, the QRC considers that the existence of the listed matters should be based on an objective test rather than a subjective test dependent on Aurizon Network’s “reasonable opinion”. Further, to ensure transparency, the listed criteria relevant to the existence of the various matters should be exclusive rather than merely inclusive.

## **2.10 Costs of applying for access**

Under UT4, an access seeker is required to cover reasonable costs of negotiation as well as other costs associated with the provision of information by Aurizon Network.

The QRC disagrees with this requirement. The QRC believes that such costs are already accounted for in the access costs budget in the development of “System Wide and Regional Costs”. Accordingly, there should be no further ability for Aurizon Network to separately levy costs associated with an access application over and above what has already provided for.

# Part 5 – Access agreements

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to the UT4 draft Access Holder Access Agreement – Coal (**AHAA**). The QRC has proposed significant amendments to the AHAA which are incorporated in the Access Agreement Mark-up (**Mark-up**).

The Mark-up should apply (as relevant) to all Standard Access Agreements. To avoid duplication, the QRC has not prepared mark-ups of the other UT4 Standard Access Agreements. However, if the QCA would find mark-ups of the other UT4 Standard Access Agreements helpful, the QRC is happy to provide these documents as part of a supplementary submission.

## 2 AHAA key issues

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This section clarifies the QRC’s position in relation to certain aspects of the AHAA but does not seek to limit the QRC’s Mark-up. Capitalised terms in this submission have the same meaning as in the AHAA unless otherwise indicated.

### 2.1 Access Rights

#### **Nature and scope of Access Rights**

The AHAA does not expressly acknowledge that Aurizon Network is required to provide the End User with the benefits, rights and services captured by the UT4 definition of “Access” on the terms of the AHAA. For clarity, the QRC has included an acknowledgement to this effect in the Mark-up.

### 2.2 Billing and payments – the right of set-off

The AHAA affords Aurizon Network an express right to set-off but does not provide the End User with a corresponding entitlement. This approach lacks commercial balance and is unreasonable. The QRC has removed Aurizon Network’s right of set-off in the Mark-up.

### 2.3 Security

#### **Requirement to provide Security on cessation of Acceptable Credit Rating**

The AHAA requires the End User to provide Security to Aurizon Network where the End User ceases to hold an Acceptable Credit Rating during the Term and Security has not otherwise been provided.

In the QRC’s view, the End User ceasing to hold an Acceptable Credit Rating should merely be a factor Aurizon Network can reasonably consider when determining if the End User should be required to deliver Security under the AHAA more generally rather than functioning as an arbitrary trigger to the provision of Security. A new sub-clause has been included in the Mark-up to reflect this position.

#### **Security Amount**

In the time available, the QRC is yet to develop a position on the Security Amount. It notes that a different Security Amount to that proposed by Aurizon Network may be warranted for some expansions – depending on the pricing principles ultimately adopted.

## 2.4 Operation of Train Services

### Supply Chain Rights

In the QRC's view, the Supply Chain Rights provisions in the AHAA are overly prescriptive and onerous. In particular, the requirement for the End User to demonstrate that it holds and will continue to hold Supply Chain Rights for the Term potentially places the End User in an untenable position if other facility providers (such as port operators) also impose similar pre-conditions or if Supply Chain Rights are for a lesser term. As currently drafted, if the End User cannot demonstrate the required Supply Chain Rights, the End User's Access Rights are potentially subject to resumption, suspension or termination. The QRC considers this to be unreasonable.

The QRC considers that the End User should be obliged only to show that it holds or has reasonable likelihood of obtaining Supply Chain Rights. To ensure End User accountability, the QRC Mark-up also obliges the End User to detail the steps the End User has taken, or intends to take, to meet this requirement if Aurizon Network requests such information.

### Relationship with the Operator

Whilst the QRC recognises that the agreed risk profile as between the End User and Operator in UT4 is to broadly resemble that of a contractor and sub-contractor, the QRC considers a number of aspects of the AHAA to not represent a fair commercial risk allocation. In particular, the QRC objects to Aurizon Network attempting to exclude all liability from the Operator.

In the QRC's view, it is appropriate for Aurizon Network's liability to be limited in aggregate as between both the End User and Operator as set out in clause 32 the AHAA (as amended by the QRC). It is however, unreasonable for Aurizon Network to require the Operator to give up all rights against the Aurizon Network, particularly where loss or damage is attributable to Aurizon Network's negligence. Accordingly, in the Mark-up the QRC has:

- (a) removed all obligations of the End User to ensure that the Operator does not bring Claims against Aurizon Network;
- (b) removed or reduced the scope of the indemnities granted by the End User in favour of Aurizon Network that relate to the conduct of the Operator;
- (c) included carve-outs in Aurizon Network's exclusions of liability for loss or damage caused or contributed to by Aurizon Network or its staff (both in respect of the End User and the Operator); and
- (d) amended the requirements of the deed poll the Operator is obliged to give to the Aurizon Network before operating any Train Services so that Operator is only obliged to agree to the limitations and exclusions to Aurizon Network's liability as set out in clause 32 of the AHAA.

## 2.5 Dealing with Access rights

### Resumption of Access Rights

The QRC considers the resumption provisions of the AHAA to be unreasonably harsh. The QRC's Mark-up has sought to provide a more balanced approach by:

- narrowing the scope of an "Underutilisation Event";

- imposing obligations of reasonableness on Aurizon Network in assessing the End User's use of its Access Rights;
- specifying time periods under which Aurizon Network must utilise its resumption rights; and
- clarifying the parties' respective notice requirements.

#### **Reduction of Conditional Access Rights due to Capacity Shortfall**

The Capacity Shortfall provisions provide that Conditional Access Rights in respect of an Expansion can be reduced where the Capacity Shortfall is caused by an act or omission of Aurizon Network. The QRC has proposed changes to these provisions so that in such circumstances, there is an acknowledgement that Aurizon Network is deemed to be in breach of the agreement. The QRC has also amended the requirements of Capacity Assessment Notices to require Aurizon Network to outline the reason(s) for the Capacity Shortfall.

#### **Reduction of Nominated Monthly Train Services if Maximum Payload exceeded**

The ability for Aurizon Network to reduce the Nominated Monthly Train Services in circumstances where the End User's Average Annual Payload exceeds the Maximum Payload was not included in the Standard Access Agreements in UT3. Although the QRC does not object to the drafting effecting this new right (as per clause 10 of the AHAA), the QRC would like to better understand Aurizon Network's rationale for its inclusion. In the QRC's view, the rationale included in UT4 appears to be inconsistent with the effect of the drafting in clause 10 of the AHAA.

#### **Reduction of Nominated Monthly Train Services if Nominal Payload increased**

Aurizon Network has the capability under the AHAA to give the End User a notice of Aurizon Network's intention to increase the Nominal Payload for a Train Service Type. In the QRC's view, the End User should also be able to initiate this process itself by making a request of Aurizon Network.

#### **Relinquishment of Access Rights – Relinquishment Fee**

The ability for the End User to relinquish Nominated Access Rights under the AHAA is conditional upon the End User's payment of the Relinquishment Fee to Aurizon Network. To encourage efficiency in the relinquishment process, the QRC has incorporated an obligation on Aurizon Network to notify the End User if Aurizon Network identifies an opportunity to enter into an Access Agreement that would result in the lessening of the End User's Relinquishment Fee and not to unreasonably delay the negotiation (and execution) of that Access Agreement.

#### **Transfers**

The QRC have proposed changes to the transfer provisions to make those provisions more efficient. In particular, there should be an efficient process to facilitate short transfers. For customers within a cluster, there should be an ability to seek pre-approval of a Transfer. A cluster refers to a group of mines within a short geographical distance of each other.

## **2.6 Compliance with Aurizon Network's Accreditation**

The accreditation provisions place considerable onus on the End User to interpret and be aware of the terms and conditions of Aurizon Network's Accreditation. The QRC considers it reasonable for this obligation to be limited to the extent that the terms and conditions have been notified to the End User. This is consistent with the approach adopted in UT4 in respect of environmental authorities.

## 2.7 Approval of Operating Plans

The QRC is opposed to the deemed refusal framework in the Operating Plan approval process. This framework has the potential to place End Users in the difficult position of not being able to determine how to proceed with an Operating Plan due to a lack of understanding of the reasons for a refusal.

In the QRC's view, the End User should be able to engage the dispute or expert resolution processes under the AHAA where a deemed refusal arises. This will ensure Aurizon Network gives proper consideration to all Operating Plans it receives.

## 2.8 Costs of implementing amendments to a System Wide Requirement

Under the AHAA, each Party is to bear its own costs of Aurizon Network varying a System Wide Requirement on "safety grounds". The phrase "safety grounds" is not defined and is too vague. Further, if a System Wide Requirement requires amendment due to conduct attributable to Aurizon Network or its staff (regardless of the grounds), the costs of that variation should be borne by Aurizon Network.

## 2.9 Indemnities by End User for liabilities to third parties

The QRC considers that the indemnity given by the End User in favour of Aurizon for liabilities to third parties is unreasonably broad. The QRC's Mark-up subjects this indemnity to the limits of liability set out in clause 32 of the AHAA (as amended by the QRC).

## 2.10 Limitations and exclusions of liability

### Consequential Loss

The definition of "Consequential Loss" in the AHAA lacks certainty. There is no settled meaning at law of "special", "indirect", "consequential" or "economic" loss. Accordingly, the QRC has deleted the first two limbs of the "Consequential Loss" definition.

### Claims and exclusions in respect of Infrastructure standard

As drafted, the AHAA provides that Aurizon Network will only be liable for Claims arising out of or in connection with the standard of Infrastructure where loss arises directly from the failure of Aurizon Network to carry out Maintenance Works or due to Aurizon Network's negligence in performing Maintenance Works.

The QRC considers this exclusion of liability to be too broad. The AHAA imposes Infrastructure obligations on Aurizon Network broader than merely the carrying out of Maintenance Works. Aurizon Network should also be liable for Claims if those other obligations are not satisfied or are undertaken negligently.

### Claims and exclusions in respect of non-provision of access

The QRC has reduced the scope of Aurizon Network's exclusion of liability for Claims in respect of non-provision of Access such that Aurizon Network will be liable where its failure to provide Access is a result of its breach or negligence.

### Claims and exclusions in respect of delays to Train Movements

The AHAA contains a mutual exclusion of liability in respect of delays to Train Movements, subject to certain carve outs. In its Mark-up, the QRC has removed the carve out for delays attributable to other Railway Operators or customers of other Railway Operators as this is a matter to be factored into the scope of the obligation (being to use reasonable endeavours).

## **2.11 Material Change**

The QRC considers the definition of “Material Change” to be unreasonably broad. The QRC has sought to limit the scope of this definition by:

- narrowing the definitions of “Relevant Taxes” and “Change in Law”; and
- removing the ability for Aurizon Network to deem a change in government funding as an additional cost of performing its obligations under the AHAA (per AHAA clause 34.3).

Given that Aurizon Network is not a government entity, the QRC does not consider there to be any basis to include clause 34.3 (or similar) in the AHAA.

## **2.12 Suspension**

The QRC Mark-up also proposes minor amendments to the suspension events in Part B of Schedule 9 to provide clarification and ensure the suspension events listed are reasonable and commercially sound.

## **2.13 Termination**

The QRC Mark-up proposes that after termination of the AHAA, the End User only be obliged to remove rollingstock as soon as is practicable, rather than within a 12 hour period. Flexibility is required to account for any delay End Users may encounter in the removal of rollingstock.

As with the suspension, the QRC Mark-up proposes minor amendments to the termination events in Schedule 9.

## Part 6 – Pricing principles

### 1 Background

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In June of 2013 the Queensland Resources Council provided a submission on the Authority's April 2013 discussion paper, "*Capacity Expansion and Access Pricing for Rail and Ports*". QRC's views are as set out in that submission, and are summarised below:

- The QRC supports the approaches to the pricing of major expansions which are set out in the Authority's discussion paper.
- If averaging the cost of an expansion across new/expanding users and existing users would increase charges paid by existing users, then a new reference tariff should generally apply to the expansion, such that existing tariffs are not increased. That is, new/expanding users should pay at least a charge which reflects the incremental cost (capital and operating) of the additional capacity provided to meet their needs.
- Where new/expanding users face a higher cost than existing users, a zero contribution to common costs is generally acceptable. That is, QRC does not consider that an expansion must necessarily make existing users better off.
- Where an expansion has a lower cost than one or more previous expansions using the same infrastructure or a lower cost than an existing average tariff, the cost should be averaged with the most expensive prior project using that infrastructure (averaging down). That is, it should not be possible to enter a system or gain capacity from an expansion at a cost which is less than the cost being paid by any existing user of the same infrastructure.
- Where an expansion delivers clear benefits to existing users, an allocation of project costs to those users (through reference tariffs) may be appropriate.
- Given that the approach to tariffs which is determined in relation to an expansion can influence the cost faced by other current and future producers, the QRC considers that it is critical that the methodology for determining tariffs is clear, transparent and fair.
- QRC understands that the application of principles to specific projects will require certain judgements to be made and that it may not be possible to draft the Undertaking to a level of precision which deals with all cases. For this reason, a process of QCA review of the application of principles is proposed whenever a new reference tariff is being established or an existing reference tariff is varied.

### 2 Rationale

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The QRC considers that the approach proposed by QRC to pricing of expansion capacity:

- is likely to provide the most stable, cost-reflective, predictable and **efficient** environment for facilitating "lumpy" investment in new port and rail capacity. The alternative, of socialising the cost of a high cost expansion with existing users:

- Is not cost reflective and does not reflect a ‘user pays’ or ‘cost-causative’ approach, as expanding users will pay less than the cost of the capacity provided to meet their needs.
- Creates a risk of inefficient investment decisions. That is, expanding users may seek capacity and trigger an expansion despite the unit cost of that expansion being so high that it is not prudent, because the expanding users will not face the full cost of that decision.
- Results in established users paying more than the stand-alone costs of providing the capacity which they originally sought and secured.
- Is likely to be perceived as a subsidy from one competitor to another and from one group of users to another group.
- Creates an incentive for existing users to oppose the expansion project, provides a bona fide reason to vote against projects in any customer consultation process, and widens the group of stakeholders which have a valid reason to demand consultation/input in regard to the procurement and construction of the project.
- is the approach most closely aligned with economic efficiency and the economic objective of Part V of the QCA Act and the pricing principles in section 168A.
- Provides a number of benefits through the “Averaging down” down approach in the case of lower cost expansions. This approach:
  - Reflects the benefits which subsequent access seekers may receive from previous investment (which was underwritten by existing Access Holders). This may be due to spare capacity being created by earlier projects, or by declining marginal costs of incremental capacity.
  - Prevents access seekers from inefficiently seeking to delay their entry into the market in order to capture a cost structure which reflects only the incremental cost of a lower cost expansion.
  - Provides access seekers who secure capacity through a high cost expansion with a potential lowering of costs over time.
  - Ensures that ‘first movers’, who in the case of a greenfield project bear more risk than later access seekers, do not, in addition to bearing this risk, also continue to pay a higher charge than later access seekers.
- Is likely to reflect the reference transaction (namely what the parties are hypothetically likely to have agreed to prior to incurring sunk costs).
- is in the public interest and in the interests of Access Seekers, as it avoids the uncertainty and disincentive to invest in mine developments which other alternatives create. Confidence in any investment decision will be adversely affected, and investment may be discouraged, if producers face a risk that the cost of a subsequent, high cost expansion may be ‘socialised’ across all users. An investor faced with this prospect would need to add to its mine feasibility study an assessment of the scope and possible cost of future rail/port expansions which may impact on its costs, despite the fact that this investor may have no further need for capacity.
- Is not inconsistent with the legitimate business interests of Aurizon Network.

### 3 Nature and purpose of the pricing principles

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QRC considers that it is important that principles such as those set out in the QRC's mark-up of Part 6 be included in Aurizon's Access Undertaking. This will promote predictability, which, as the Authority notes, "*is likely to promote confidence in the regulatory arrangements and also economic efficiency by reducing uncertainty associated with long term decisions*" (Discussion paper, 2.3). The principles should have the purpose of providing information regarding the approach to pricing which is generally expected to be applied in the absence of compelling reasons to adopt any alternative approach. That is, we agree with the Authority's approach as set out in the Executive Summary of the Discussion Paper which includes a case by case assessment of the application of pricing principles:

*"Because of the importance of the particular circumstances that apply in each case to the pricing of new access capacity, it is not possible to define hard and fast rules that can be applied to price access to any capacity expansion efficiently and fairly. The pricing of access to major capacity expansions will thus need to be decided on a case-by-case basis. However, there are some key propositions that are based on relevant economic efficiency, fairness and governance principles, which can help in arriving at fair, efficient and practical regulatory decisions."*

QRC considers that these 'key propositions' should be set out in the Access Undertaking, while the final decision regarding pricing for each major expansion should be made by the Authority following a process involving stakeholder consultation.

Examples of some of the circumstances which may need to be considered include:

- Where Access Conditions have been imposed (charges or terms which differ to regulated charges and standard agreements), these must be considered, as the regulated charges faced by existing and/or expanding users may not be indicative of the true costs of access.
- Where an expansion involves a high initial unit cost due to the creation of spare capacity, a period of capitalisation of returns and deferral of depreciation may be appropriate rather than the simple application of the pricing principles, which would result in the first users of the expansion paying more (initially) than later users.
- Where existing customers have borne special risks such as greenfield development risks, or incurred unusually high costs due to low initial volumes, some form of rebate payable by new users may be appropriate (for example, a temporary price premium which levies the costs of initial and subsequent users over a period of time, or a contribution to common costs beyond incremental costs).
- Existing users may receive some benefit from an expansion, such as reduced congestion, an ability to run longer or faster trains, or future maintenance cost savings. In these cases, some level of increase in existing charges may not be inconsistent with a 'no worse off' approach.
- Existing users may receive some 'dis-benefit' from an expansion project, such as increased congestion, or may incur an additional cost in order to assist in creating capacity (for example, due to a change in above rail operations or coal loading practices). In such cases, there may be justification for a premium to apply to the tariffs of new users such that the charges of existing users are reduced.

QRC acknowledges that a case by case assessment of the application of the principles has the effect of reducing certainty and predictability. For this reason, it is important that the application of pricing principles in regard to each project be determined early in the

life of the project: prior to Access Seekers entering into binding Access Agreements, and prior to any customer voting process being undertaken.

## 4 Concerns with the existing drafting of UT4

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The draft UT4 seems to create a ‘default’ approach to pricing which reflects the incremental cost of the relevant expansion, with Aurizon Network able to depart from this approach after seeking the approval of Customers or of the Authority (although there seems to be no scope to depart from the default approach where the new or additional services involve a new loading facility). QRC’s concerns with the existing draft UT4 include:

- Dealing with Expansions for which an existing reference tariff applies (Section 6.2.4) under separate provisions from the case where an existing reference tariff does not apply (Section 6.2.5) is confusing and potentially leads to different outcomes for otherwise similar circumstances. QRC considers that the same process of assessment and determination should apply for all new or additional train services, regardless of whether an existing reference tariff is in place or not.
- The concept of a lower cost expansion ‘averaging down’ with the highest relevant existing reference tariff has not been reflected. The drafting refers to the ‘relevant existing reference tariff’, however, given that it is proposed that a new reference tariff will be established in certain circumstances (see 6.2.5(d)), it is not clear which of the reference tariffs within a particular system is the ‘relevant’ tariff. In QRC’s averaging down approach, the relevant existing tariff is the highest existing tariff in the system, to the extent that this tariff relates to the use of the same infrastructure.
- QRC does not consider that the application of pricing principles is an appropriate matter for a customer vote (Section 6.2.4(a)(iv)). The vote would provide large existing Customers with a level of influence over pricing decisions which is not available to smaller Customers.
- The draft Undertaking provides no indication of how the Authority would assess a pricing proposal received in regard to a particular Expansion other than the very general parameters provided in 6.2.6(b). QRC considers that principles should be included in the Undertaking which provide information on the matters which would be considered. These principles should reflect a ‘default’ expectation (i.e. that all new or additional services will be priced at least at the level required under Section 6.2.5) and should provide guidance on the matters which the Authority would consider in its assessment of a proposed departure from this approach.
- QRC considers that the drafting of the definitions of “Distance Discount” and “Minimum Revenue Contribution” require amendment.

Aurizon Network has expressed general support for the concepts discussed above. QRC therefore intends to work with Aurizon Network to confirm this support and to develop proposed drafting to implement this approach. Given the complexity of this area, we have not sought to mark up Section 6 of the Undertaking in this submission.

## 5 Guiding Principles

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We suggest that the undertaking should set out the matters which QCA will consider when assessing a proposal to amend an Existing Reference Tariff or create a new Reference Tariff. We would suggest that the QCA should have regard to the following (potentially competing) objectives:

- The objectives of the Act;
- Reducing uncertainty, and encouraging investment, by ensuring that existing Access Holders and their Customers (each of which has entered into long term commitments) are not made worse off as a result of a subsequent Expansion. A consideration of whether a party is 'worse off' will involve consideration of factors including any increase in Access Charges and any economic benefits to existing Access Holders and Customers from the relevant Expansion;
- The need for new/expanding Access Holders to pay Access Charges which reflect at least the incremental cost (capital and operating) of the capacity created for their use (less the value of any economic benefits to existing Access Holders and Customers); and
- The objectives of fairness.

## 6 Issues of detail relating to pricing principles

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In developing the proposed approach to the pricing of expansions, QRC members have considered a range of related issues. The QRC's views on these matters are set out below:

**How long should a 'premium' tariff apply for:** Premiums should apply for up to 10 years, then tariffs socialise to a standard system tariff in regard to the 'common' sections of track (premiums would continue on 'dedicated' sections to the extent that these are in the RAB).

**How should renewal contracts be treated:** Renewed Access Rights should be at the tariff that applied to the underlying Access Rights being renewed, not default to any higher tariff. Note that Access Rights paying a premium tariff would most likely be renewed at a lower, socialised tariff due to item the proposed ten year limit on premiums.

**What should happen upon default or relinquishment:** If one of the users of an expansion project for which a premium is paid relinquishes capacity or defaults, the effect of the lost revenue could be socialised within the expansion group, or alternatively across the system. We recommend socialisation across the system as currently occurs. The mechanics of this need to be developed but the intention is that, following the relinquishment/default, the costs previously attributable to that user (which were part of the calculation of the premium tariff) would be spread across all users of the system (including the group paying the premium). Similarly, any relinquishment fees or benefit of security (including through Access Conditions) would be credited against the entire system. Considerations which lead to this recommendation are:

- In the case of relinquishment, the relinquishment fees cover 50% of the NPV of the lost revenue, mitigating the impact.
- In all cases (relinquishment, default) the system benefits from the spare capacity created.
- Default is unlikely while operators hold the Access Rights (a mine failure won't lead to default in this case).
- Exposing a small group (expanding customers) to the default risk of others who are expanding at the same time does not seem reasonable – no mine is in a position to challenge Aurizon's decision to enter into an Access Agreement with another mine nor stipulate appropriate credit risk protection.
- The socialisation of default/relinquishment risk proposed above is the same as that which applies under UT3.
- Payment default risks are, and should remain, an Aurizon Network risk.

QRC notes that if an Access Seeker enters into an Access Agreement and subsequently defaults, the reduction in demand will result in a higher cost of access for other Access Holders in the relevant system. Due to the socialisation of risk inherent in the regulatory arrangement, QRC suggests that security arrangements for new Access Agreements should be considered as part of the UT4 process and set out in the undertaking.

**How will a new contract which makes use of relinquished (or not renewed) capacity (whether created by an expansion to which a premium tariff applies or otherwise) be treated?** QRC suggests that, consistent with the principle that no later Access Seeker should obtain capacity at a lower cost than an existing group of Access Holders, the new user should pay a tariff which is socialised with the most expensive existing group using similar infrastructure, reducing the premium of that group.

**How will the revenue cap apply to a group paying a premium tariff:** For any group which is paying a premium tariff (and for as long as they are paying it), full take or pay should apply to each Access Holder in the group, with no system trigger test. This will eliminate revenue cap unders/overs and eliminate any issues regarding the impact of the expansion on ToP triggers of existing Access Holders. ToP elements of the tariff could be charged as fixed monthly amounts. The expansion group should revert to standard ToP (whatever that is at the time) when a premium tariff no longer applies. Tariffs for the group will be based on contract, not forecast tonnes. However, for testing whether the group should be/remain subject to the premium, forecasts rather than contract should apply (because the special ToP terms will not apply to the group when it ceases to be subject to a premium tariff).

**Within the first ten years, can the premium tariff merge with another tariff:** A premium tariff may reduce over time due to factors such as volume increases (if the capacity is not immediately fully contracted) or faster depreciation. In theory, a differentiated tariff could become lower than an existing system tariff within the ten year premium period. In this case, the premium tariff should then be merged with the next highest relevant tariff in the system.

## 7 Comments on definitions relevant to Part 6

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### Minimum Revenue Contribution definition:

- The definition seems to add an AT1 value (in \$/Gtk) to items (a) and (b), which are in \$/t. Perhaps the intent is that the AT1 value should first be converted to \$/t.
- The purpose of the 90% factor in item (a) is unclear.
- In item (a), dividing by the contracted tonnes for the Coal System does not seem correct. We understand that this is intended to be the additional contracted tonnes within that Coal System resulting from the new or additional Access Rights.
- The conversion referred to in item (b)(ii) cannot be completed just by reference to a System Nominal Train Payload. An assumption must also be made regarding the gross tonnes of the train and haul distance.
- The purpose of Part (b) of the definition is unclear. The result of Part (b) will always be substantially less than the existing reference tariff, so part (b) will never apply under 6.2.5.

### Distance Discount:

- The factor (ART-MRC) could be negative, in which case the distance discount could become a premium rather than a discount.
- The conversion referred to in “ART” cannot be completed just by reference to a System Nominal Train Payload. An assumption must also be made regarding the gross tonnes of the train and haul distance. Is ART intended to be a calculation for the relevant mine or for the system (assume it should be for the mine).

# Part 7 – Available capacity allocation and management

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to available capacity allocation and management under UT4, as captured in UT4 Part 7 (**Part 7**).

In summary, the QRC proposes the following key amendments to the capacity allocation and management framework:

- 1 Acknowledgement that at the time of allocating available capacity it is unlikely and unnecessary for an access seeker to hold all rights ancillary to the rail network access rights being sought including supply chain rights, rail haulage rights and other infrastructure rights. Rather, it is sufficient for an access seeker to demonstrate a reasonable likelihood of utilising the access rights by the time the access rights are to commence;
- 2 The inclusion of a requirement for Aurizon Network to promptly negotiate with a renewing access seeker and the safeguarding of a renewing access seeker from losing priority because of an act, omission or delay by Aurizon Network;
- 3 An acknowledgement that Aurizon Network will facilitate the transfer of access rights in circumstances where a proposed transfer is to result in the transfer of all or part of an access holder’s existing access rights and the transferee meets the capacity allocation criteria. In such circumstances, the QRC considers that transfers should take priority over other access seekers;
- 4 The modification of the negotiation process to be applied in respect of transfers to require Aurizon Network to act expeditiously and in accordance with shorter timeframes;
- 5 The requirement for Aurizon Network to publicise a register of access holders who have indicated that they are considering effecting a transfer and have consented to such disclosure. The QRC considers this is required to assist access holders with effecting a transfer by notifying other interested parties of available capacity;
- 6 The removal of the ability of Aurizon Network to choose between mutually exclusive access applications on the basis of its “legitimate business interests”, including its ability to consider “revenue adequacy” and “allocate capacity to the highest marginal value”. The QRC considers such that criteria is unfair, too broad, largely subjective and fails to balance the interests of all parties. Rather, the QRC considers that an impartial and easily verified criteria should be adopted;
- 7 The inclusion of a requirement, rather than mere ability, for Aurizon Network to develop system rules where they do not already exist for a coal system;
- 8 The inclusion of a requirement for any amendment to the system rules to be approved by the QCA. The QRC considers that this is consistent with the requirement for initial system rules to be approved by the QCA; and
- 9 The inclusion of an obligation for Aurizon Network to review and amend the system rules where there is an increase in system capacity of greater than 30%, an expansion requires an increase in capacity of greater than 30%, or 60% of access holders in a coal system request a review.

The mark-up of Part 7 which reflects the amendments proposed by the QRC are set out separately in the mark-up document titled “Part 7 – Available capacity allocation and management” (**Mark-up**).

## 2 Available capacity allocation and management

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This section clarifies the QRC’s position in relation to certain aspects of the UT4 capacity allocation and management framework but does not seek to limit the QRC’s Mark-up.

### 2.1 General requirements for capacity allocation

The queuing framework included in UT3 has been dismantled in UT4 in favour of specified capacity allocation criteria centred around whether an access seeker can fully utilise the access rights sought. Aurizon Network considers that the queuing framework no longer serves a useful purpose in the current environment where the network capacity is constrained.

Whilst the QRC agrees with the shift towards capacity allocation criteria, as the criteria is currently drafted, Aurizon Network is provided with too much discretion. The capacity allocation criteria fails to acknowledge that at the time at which available capacity is allocated by Aurizon Network, it is unlikely that an access seeker will be able to demonstrate an ability to fully utilise the access rights requested. At that point in time, an access seeker may not actually hold all rights which are ancillary to the rail network access rights being sought, including supply chain rights, rail haulage rights and other infrastructure rights. An access seeker should not be prevented from seeking access rights solely because those ancillary contractual rights are not finalised at that early stage. The QRC considers that if an access seeker provides evidence of a reasonable likelihood of having the necessary ancillary contractual rights by the time that the access rights are to commence, this should suffice.

The QRC also considers that the following factors, which form part of the list of considerations relevant to whether an access seeker can fully utilise its access rights, are superfluous and should be removed:

- “rights to load and unload train services”; and
- “sufficient facilities (including rollingstock, provisioning facilities, maintenance facilities and storage facilities) to enable the access seeker to utilise the relevant capacity”.

These factors are already encompassed by the definition of “Supply Chain Rights” which is also a consideration for the purpose of determining an access seeker’s ability to fully utilise its access rights. Also, the QRC considers it is not Aurizon Network’s place to scrutinise whether an access seeker (or haulage provider) has sufficient facilities to enable use of the relevant capacity in circumstances where it has a rail contract.

### 2.2 Renewal process

Under UT3, a renewing access holder was afforded priority in the queuing framework. Under UT4, an access holder only has priority to renew an access agreement if a new agreement is executed at least 12 months prior to the expiry of the access holder’s existing access rights. However, Aurizon Network is not obligated to negotiate with a renewing access seeker in relation to a renewal more than three years prior to the expiry of the current access rights.

The QRC considers there should be an obligation on Aurizon Network to promptly negotiate with a renewing access seeker as soon as a valid renewal notice is provided. There should also be no requirement for a renewing access seeker to submit a new access application, except where renewal is for capacity below the level currently contracted. There seems to be no benefit in making a renewing access seeker provide an access application.

Further, the QRC considers that a renewing access seeker should not be at risk of losing its priority due to a failure to execute an access agreement at least 12 months prior to the expiry of the access rights, where that failure is caused by an act, omission or delay by Aurizon Network.

The QRC also considers that the ability, under UT3, for a renewal right to be used in respect of a replacement mine should be reinstated. As a matter of practicality, an access holder whose mine reserves are declining is likely to have a new mine in the same area, which may be part of the same coal seam.

## 2.3 Transfer of access rights

Many of the transfer provisions have been removed from UT4 (as compared to UT3) as Aurizon Network proposes to deal with the transfer of access rights predominately under the standard access agreements. The QRC generally agrees with this change.

The QRC is however concerned with three changes to the transfer provisions in UT4.

Firstly, UT3 placed an obligation on Aurizon Network to transfer access rights in certain circumstances, such as where the transferring access rights are for the same train service entitlement as the access rights sought. In UT4, this obligation has been removed such that Aurizon Network is not obliged to execute an access agreement with a transferee in any circumstances. The QRC disagrees with this position. Aurizon Network should not be afforded complete discretion as to whether a transfer is permitted regardless of the circumstances. Aurizon Network should be required to transfer access rights in certain circumstances. Where a proposed transfer is to result in the transfer of all or part of an access holder's existing access rights and the transferee demonstrates its ability to fully utilise the access rights (such as by having secured, or being reasonably likely to secure, supply chain rights), and that there is available capacity, Aurizon Network should be required to facilitate the transfer by executing an access agreement with the transferee. In this way, transferees should have priority over other access seekers (other than renewing access seekers) to the extent of the access rights which are the subject of the transfer. For this reason, the QRC considers that to avoid confusion, the ability for Aurizon Network to consider other access applications should be removed from the transfer provisions.

Secondly, UT4 provides for the negotiation of transferred access rights to be conducted in the same way as a fresh application for access rights. The QRC considers that the timeframes imposed under that framework are excessive for the negotiation of transferred access rights. The timeframes which apply in respect of a new application for access rights are not an appropriate reflection of the timing reasonably required for the negotiation of transferred access rights. Rather, Aurizon Network should be required to act expeditiously and complete the steps involved in the negotiation process in shorter timeframes. This will assist with achieving the timing of a proposed transfer.

Further, in respect of a short term transfer (i.e. a transfer of less than one month), timeliness of effecting the transfer is imperative. Aurizon Network has itself recognised a need to allow for "*a more readily accessible short term capacity transfer process*". Accordingly, the QRC considers that Aurizon Network should be required to apply an abbreviated negotiation process in the case of a short-term transfer.

Thirdly, UT3 provided for a capacity notification register and a committed capacity register to allow for interested access seekers to receive information concerning the

allocation of access rights. These registers have been removed from UT4. Aurizon Network considers there is no longer any requirement for the registers due to the removal of the queuing framework. Despite this, the QRC considers there remains a need for a register of access holders who have indicated to Aurizon Network that they are considering effecting a transfer (and consent to appearing on such a register). This will assist with effecting a transfer by notifying other interested parties of available capacity.

## 2.4 Pre-approval of transfers

The QRC suggests that there would be merit in a process to pre-approve some transfers. Under this arrangement the capacity test would have been completed and the transfer fee calculated. Pre-approval could not apply to all transfers – only those with similar distances (e.g. close by mines).

## 2.5 Mutually exclusive access application criteria

Under UT3, where there were mutually exclusive access applications, a queue was formed under which “first in” is “best dressed”. As mentioned above, the queuing framework has been removed in UT4.

UT4 contemplates that where there are mutually exclusive access applications that meet certain criteria (i.e. the application is for coal carrying train services, the access seeker has satisfied Aurizon Network of the factors contained in clause 4.11(c), the access rights requested could be used without adversely affecting the ability of existing access holders to use their access rights etc.) or where none of the applications meet the criteria, then Aurizon Network will enter into negotiations with those access seekers who best meet Aurizon Network’s “legitimate business interests”. Clause 7.5.2(d) of UT4 also includes more detailed objectives for establishing the matters that Aurizon Network may consider in this context, but those matters are not limited by the listed objectives.

Aurizon Network contends that consideration of its “legitimate business interests” on the basis of “revenue adequacy” and allocating capacity to its “highest marginal value” “reflect the overall objectives of the access framework” and is “reasonable in terms of achieving a balance in the interests of the parties”.

The QRC disagrees with this proposition. The criteria and unlimited objectives by which Aurizon Network may choose to proceed with one access seeker over another is unreasonable and unfairly biased in favour of the interests of Aurizon Network. The QRC considers that Aurizon Network should not have such unilateral and complete discretionary control over making this decision. Whilst some factors are listed for Aurizon Network to consider, those factors are not exclusive and are largely subjective.

The QRC considers that Aurizon Network should be obliged to make this decision based on only transparent, impartial and easily verified criteria. Consideration of whose application best meets Aurizon Network’s “legitimate business interests” is an ambiguous and inappropriate standard by which one access seeker should progress to the negotiation process over another. Rather, more balanced and transparent criteria should be adopted on an exclusive basis.

## 2.6 Network Management Principles and system rules

The QRC considers that where system rules do not already exist for a coal system, Aurizon Network should have an obligation to develop initial system rules, rather than the mere ability to do so.

The QRC supports the inclusion of a requirement for any amendments to the system rules to be approved by the QCA. This is consistent with the requirement for initial system rules to be approved by the QCA.

The requirement for QCA approval will also ensure that any submissions made by an affected person are adequately considered and that the proposed amendments operate equitably among access seekers and access holders.

The QRC considers there should be an obligation, rather than a mere discretion, for Aurizon Network to review and amend the system rules where:

- system capacity increases by greater than 30%; or
- an expansion is required to increase system capacity by greater than 30%; or
- 60% of access holders in a coal system formally request such a review.

The QRC considers that in such circumstances, a review of the system rules will be necessary to ensure the system rules continue to adequately govern the changes to train services.

# Part 8 – Network development and Expansions

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to Aurizon Network’s network planning, expansion and expansion funding obligations under Part 8 of UT4 (**Part 8**).

Network planning and expansions are crucial parts of UT4. Expansion planning, negotiation and development has been the most problematic area of rail infrastructure over the past 5 or more years. The experience of industry has been that expansion scoping and negotiation is inefficient, unnecessarily protracted and one-sided. There has been little effective protection against Aurizon Network’s monopoly power, which power it has exercised to the detriment of the industry. The risk of such issues is only magnified by the proposed terms of UT4.

Aurizon Network has proposed a wholly new network planning and expansion section. It represents a significant movement away from UT3. It is however a movement in the wrong direction. Part 8 as proposed by Aurizon Network substantially lessens Aurizon Network’s obligations (for example removing the \$300M mandatory funding obligation which was a key plank of UT3) and providing Aurizon Network with substantially more discretion and control over Expansion planning.

The QRC has communicated to Aurizon Network its key concerns as follows:

- (a) That UT4 should contain a meaningful and practical suite of options for funding of Expansions and that Aurizon Network funding at the regulated WACC must be a key element of that suite;
- (b) That network development planning needs to be more robust, regular and more transparent;
- (c) That the process for studying, scoping and agreeing on an Expansion must be more prescriptive, objective and mechanical. It cannot be subject to the discretion of Aurizon Network or broad and ambiguous tests which undermine the detail of Part 8 - for example the references to legitimate business interests and the commercial objectives of Aurizon Network. There should be a clear right to dispute determinations made by Aurizon Network in the prioritisation of projects and selection of participants for projects.

In the QRC’s discussions with Aurizon Network, Aurizon Network produced an updated version of Part 8 submitted to the QCA. That revised version does not address the substance of the QRC’s comments.

Section 8.1 of the QRC mark-ups contains the QRC’s mark-up of the updated version of Part 8 provided by Aurizon Network. Section 8.2 contains the QRC’s mark-up of the version of Part 8 submitted to the QCA for consideration. References in this submission to the **Mark-up** are to Section 8.1. References to clauses of Part 8 are references to the updated version of Part 8 provided by Aurizon Network (and not the version provided to the QCA as a part of its UT4 submission).

## 2 A suite of Expansion funding options and Aurizon Network’s funding obligation

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### 2.1 Summary

Industry considers that a suite of funding options for Expansions must be developed to promote economically efficient investment in the Central Queensland Coal Network. This suite of options must include:

- (a) Funding by Aurizon Network at the regulated rate of return under a voluntary funding commitment;
- (b) An efficient funding option for small-medium sized projects which are beyond any limits of Aurizon Network’s voluntary commitment;
- (c) SUFA;
- (d) The ability of QCA to approve Access Conditions where Aurizon Network offers to fund beyond its commitment and can demonstrate a material difference in risk of the project relative to the risk of the existing asset base.

### 2.2 The UT3 experience

UT3 included a form of items (a) and (d) which proved to be ineffective.

Aurizon Network had a funding obligation for Expansion projects less than \$300M, but there was no effective mechanism to ensure that projects were not aggregated and deferred until a project of greater than \$300m was required.

For projects in excess of \$300M Aurizon Network could seek access conditions, subject to a QCA approval process. Access conditions in reality translated to greater security protection, greater take or pay protection and a premium above the regulatory rate of return. Industry’s experience with the regulatory oversight of access conditions was that it was ineffective and did not reduce the rates of return sought by Aurizon Network. Nor did access conditions provide an expedited process – in fact the opposite. Fundamentally, access conditions did not provide a check on Aurizon Network’s monopoly power. Expanding coal producers were placed in a position of having to actively support the Access Conditions sought by Aurizon Network, including in submissions to the QCA, in order to prevent further delays to projects.

### 2.3 UT4

From industry’s perspective it is vitally important that the undertaking include a range of Expansion funding obligations. There cannot be a one size fits all approach. The Expansion funding regime should be drafted into the undertaking in a prescriptive form, such that negotiation is minimised, and that delay is avoided. For the reasons set out in the QRC’s “regulatory policy” submission, we do not consider that a model of regulation that involves negotiations with a monopoly without effective dispute resolution is workable.

Aurizon Network’s proposed approach to funding expansions involves the following options:

- (a) Aurizon Network, in its discretion, choosing to fund an Expansion at the regulatory rate of return. Industry’s experience with Aurizon Network is that it

has an expectation of seeking a premium above the regulatory rate of return for most Expansions.<sup>57</sup> Therefore this option is likely to be rarely offered.

- (b) Aurizon Network funding with “Commercial Terms”, which are a rebadging of access conditions, but with regulatory oversight removed; or
- (c) User funded using SUFA: a complex, untested, and currently incomplete framework.

Industry finds none of these options particularly encouraging. In the absence of substantial progress on other options, the default will be “Commercial Terms” – under which Aurizon can impose access conditions free of any practical constraint other than the limitations of the viability of mining projects. This does not provide for economically efficient investment in the Central Queensland Coal Network. In our view, investment at the regulatory WACC is the economically efficient model as, in the absence of material differences in the risk profile of the project, any other rate of return claimed by Aurizon Network imposes inefficient costs, and will result in a level of investment in the Central Queensland Coal Network, the coal industry, ports and all related services which is less than optimal. The problem created by Aurizon Holdings’ structure, being that it may well have a cost of capital which exceeds that of a stand-alone below rail business, is its own creation and can readily be addressed.

Similarly, SUFA should not be seen as a suitable model for routine use as it will involve substantial transaction costs and a cost of capital which (due to differences in risk under the SUFA structure) will exceed the efficient cost of capital for below rail infrastructure.

Faced with the reality that “Commercial Terms” is likely to be the default model under the draft UT4, QRC proposes that, until a workable suite of funding options is developed, the undertaking should explicitly **prohibit** Aurizon Network from investing in the network other than based on regulatory returns and conditions. This is intended to encourage Aurizon Network to:

- (d) Develop an effective suite of funding options as described above in the earliest possible timeframe.
- (e) In the meantime, to the extent that expansions are required, either voluntarily fund on regulated terms or genuinely seek to facilitate the implementation of a SUFA project.

The Expansion funding obligation is for all parties difficult. The position proposed by Aurizon Network in UT4 is an extreme one – essentially it removes the role of the QCA and provides no meaningful expansion funding obligation. A meaningful compromise with a suite of Expansion funding obligations needs to be found.

## 2.4 Note: Voluntary funding obligations under UT4

The only funding obligation in UT4 is in respect of asset renewals. However, the definition of “Asset Replacement Expenditure” is too narrow. “Asset Renewal Expenditure” should expressly include reconstruction of damaged, lost or destroyed parts of the Rail Infrastructure (such as loss resulting from a flood).

Aurizon Network has proposed a change to the funding of Capacity Shortfall projects. Aurizon Network propose that Capacity Shortfall projects be funded in the same way as the original project.<sup>58</sup> The QRC accepts this, but considers that there should be a

<sup>57</sup> Please refer to page 47 of Aurizon Network’s investor briefing of 29 April 2013.

<sup>58</sup> Note: Aurizon Network have proposed that its obligations to fund Capacity Shortfall be subject to a ‘commercial objectives’ test. This undermines the obligation and has been rejected by the QRC.

principle that where a Capacity Shortfall is caused by an act or omission of Aurizon Network the relevant portion of costs should be borne by Aurizon Network.

Certain other funding commitments (not documented in the draft UT4) have been indicated in Aurizon’s submission document. These are:

- HPX3, Rolleston electrification, Lillyvale; and
- Completion of GAPE and WIRP (under access conditions).

Aurizon Network has subsequently indicated a willingness to fund the following at regulated risks/returns:

- Duplication of and possible grade separation at the cooling channel bridge at the entrance to the RG Tanna Coal Terminal.
- Two minor duplications and/or loops to facilitate transfers.
- Minor incremental expansion projects for two of the Goonyella, Blackwater or Moura systems.

### 3 The Expansion Process

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The ‘Expansion Process’ refers to that part of Part 8 from concept studies, pre-feasibility studies, feasibility studies and to entry into an access agreement.

#### 3.1 General principles which undermine the remainder of Part 8

Clause 8.2 and 8.10 contain general principles which serve to undermine the detail of the remainder of Part 8. Clause 8.2 provides that despite the remainder of Part 8 Aurizon Network is not obliged to do anything which is contrary to its “legitimate business interests”. Clause 8.10 provides that Aurizon Network is not obliged to comply with the Capacity Shortfall obligations to the extent inconsistent with its “commercial objectives”.

The difficulty with such broad brush provisions which are stated to be despite any other provision is that they undermine the detail and prescription of the other provisions. The QRC considers that these provisions should be deleted entirely. They are unnecessary. The purpose of Part 8 is to set out in detail the process to be undertaken. The detailed process should embed the protections necessary to protect Aurizon Network’s legitimate business interests.

In relation to clause 8.10.3, the QRC considers that it is simply inappropriate that Aurizon Network should have a right to excuse itself from its obligations where to do so would be inconsistent with its commercial objectives.

More generally, the QRC’s Mark-up attempts to include greater objectivity to each phase of the Expansion process, together with an ability to refer a matter to dispute resolution. The QRC considers that those changes are entirely appropriate given the impact which Aurizon Network’s determination may have on Access Seekers.

#### 3.2 Studies, funding of studies and standard study funding agreement

Aurizon Network had proposed that studies would be funded by Aurizon Network or Customers, as agreed. Aurizon Network also provided a relatively loose process to move between concept, pre-feasibility and feasibility studies.

As is noted earlier in this submission, the QRC considers it important that there be a much more mechanical, objective and prescriptive process. The criteria to move between stages should be objective and Aurizon Network’s determination of matters such as

prioritisation of projects, selection of participants in a study and ultimately allocation of capacity should be subject to dispute. Without such a mechanical, objective and prescriptive process there is scope for delay and there is no check on Aurizon Network's monopoly power.

The QRC proposes that concept studies be undertaken by Aurizon Network at its cost. Pre-feasibility and Feasibility studies should be treated differently. First, Pre-feasibility and Feasibility studies should be funded by Access Seekers. There are three reasons for this:

- (a) Imposing a requirement on Access Seekers to pay the costs of a study will act as a disincentive to less progressed Access Seekers seeking to participate in a study. There is a negative impact on both Aurizon Network and other Access Seekers where a project is scoped for Access Seekers that are unlikely to be able to participate in an Expansion project.
- (b) Imposing a requirement on Access Seekers to pay the costs of a study allocates the burden of cost to those Access Seekers requiring the Expansion.
- (c) Requiring Access Seekers to fund the study provides them with greater insight and input into scope development for an Expansion. Given that Access Holders ultimately bear the costs of an Expansion and that Access Seekers need greater transparency of projects to feed into their mine and port projects, more transparency and input into Expansions is crucial.

For the above to be effective, it is necessary for Aurizon Network to be prohibited from providing study funding (with the exception of concept studies).

Aurizon Network have proposed standard study funding agreement terms for Pre-feasibility and Feasibilities. The QRC does not support the terms of those agreements for the following reasons:

- (a) The agreements provide insufficient scope for Access Seekers to have input;
- (b) The agreements are unnecessarily complicated;
- (c) The costs which may be claimed under the agreements are too vague (such that Aurizon Network could claim an unnecessarily broad category of costs);
- (d) The liability position does not reflect a market standard engineering study agreement. If Aurizon Network wishes to conduct studies personally, it should offer market standard terms.

The QRC has developed its own study funding agreement which it considers reflects market practice. That agreement could be utilised for both Pre-feasibility and Feasibility agreements.

The QRC has also proposed both in the undertaking and study funding agreement that Access Seekers should have a right to step-in where Aurizon Network unreasonably delays entering into a study funding agreement and (after a study funding agreement has been executed) Aurizon Network delays undertaking the study. Without such a right Access Seekers will have not have any effective remedy (given that Aurizon Network are unwilling to offer liquidated damages for delays on its part).

## 4 Scope of Expansions

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The QRC has proposed that the scope of work for Expansions should be agreed by relevant Access Seekers. Further, to the extent that Aurizon Network and Access Seekers cannot agree on the scope of an Expansion, such scope should be determined by an expert.

UT4 does not give Access Seekers any input into the scope of Expansions. There are a number of reasons why Access Seekers should have input into the scope of work:

- (a) Aurizon Network have proposed that each Expansion access agreement be conditional upon sufficient capacity being delivered by the Expansion. Aurizon Network therefore does not bear any risk if the Expansion fails to deliver the capacity contracted. It cannot be the case that Access Seekers bear the risk of the Expansion delivering the required capacity and yet have no ability to challenge the proposed scope of work.
- (b) Access Seekers ultimately bear the cost of an Expansion. It is therefore only fair that Access Seekers have input into the scope.

In addition to Access Seekers agreeing with Aurizon Network the scope of Expansions (or having such scope determined through dispute resolution), Aurizon Network should not be able to materially change that scope without obtaining the prior agreement of the relevant Access Seekers. It is recognised that there would be scope changes which are mandatory (such as latent conditions and change in law) where an Access Seeker cannot dispute the need to effect a change.

## 5 SUFA

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Part 8 includes limited provisions to deal with SUFA. A number of additional provisions are required to facilitate SUFA. They include:

- (a) An obligation on Aurizon Network to seek regulatory pre-approval of the scope and standard of a SUFA project. The more that a project can be de-risked for an Access Seeker the easier it will be to obtain finance for the project.
- (b) Aurizon Network should be under an obligation to seek inclusion of the costs of a User Funded Project in the RAB. Further, Aurizon Network should be obliged to consult with relevant funding users on the submission to be made to the QCA.
- (c) The Standard User Funding Agreement will not be tax effective without a number of tax rulings. Aurizon Network should be obliged to seek a tax ruling for the standard documents and for each User Funded Project. The QRC has developed drafting for the tax ruling. That drafting is unfortunately longer than what we would hope for. It is however reflective of the complex nature of SUFA.
- (d) Aurizon Network should be obliged to review the Standard User Funding Agreement promptly after the documents for the first User Funded Project are signed. Given the complexity of SUFA there will inevitably be lessons learned and glitches in the documents.

## 6 Network development plan

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The QRC is very supportive of the concept of a Network Development Plan. For that plan to be useful:

- (a) It should be defined in such a way as to specify the level of detail it should include;
- (b) It should be kept up to date;

- (c) It should be transparent and accessible by all Access Seekers and Access Holders.

## 7 Capacity review and system operating assumptions

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The QRC consider that the capacity review section requires substantial amendment. In particular:

- (a) Capacity reviews should be undertaken not less than annually. UT4 provides Aurizon Network with discretion as to when it undertakes a Capacity assessment.
- (b) Capacity reviews should be more consultative. For Aurizon Network to have a better understanding of coal chain impacts it should be obliged to consult.
- (c) Aurizon Network should be obliged to engage an independent expert to assess Capacity and provide a copy of that expert's report to Access Holders and Access Seekers. Capacity modelling is both highly technical, but also a function in which a degree of impartiality is required.
- (d) Access Seekers and Access Holders should be entitled to dispute Aurizon Network's determination of Capacity.

Aurizon Network have proposed that it be entitled to amend System Operating Assumptions from time to time. The System Operating Assumptions will have an impact on Capacity. Any amendment to System Operating Assumptions should require the approval of the QCA.

## 8 Acceptance of capital expenditure projects by Interested Participants

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The QRC does not agree with the user voting framework proposed by Aurizon Network under UT4. Rather, the QRC supports a voting framework based on that contained in UT3. The voting process under UT3 is familiar to the industry and should therefore be maintained to the extent possible.

The QRC agrees with Aurizon Network's efforts to improve the level of information provided to users in respect of user voting. Therefore, whilst the QRC considers that the provisions under UT3 should be reinstated in the most part, it recognises that some concepts adopted under UT4 should also be incorporated.

### 8.1 Key differences between UT3 and UT4

The voting framework under UT4 is significantly different from that contained under UT3. The key differences in the QRC's opinion are as follows:

- Under UT3, a user was only permitted to vote on the prudence of scope of a project. Under UT4, this has been extended to include the prudence of standard, as well as cost allocation principles for a proposed reference tariff in relation to an expansion.
- UT4 requires information to be provided to participants in the voting process by way of targeted working papers rather than via the CRIMP.

- In the event of a 'no' vote on a project, UT4 requires a user to provide sufficient reasons identifying why the project was not supported. Further, where a 'no' vote does not include sufficient reasons Aurizon Network has the ability to exclude that vote.
- UT3 provided that any disagreements regarding whether a user formed part of a particular user group for the purpose of a vote was referred to the QCA. Under UT4, the involvement of the QCA has been removed such that the only recourse open to a user is to notify Aurizon Network. The decision as to whether a user should be included in a vote rests solely with Aurizon Network.
- UT4 removes the requirement for QCA approval following the completion of a successful user vote in relation to the prudence of scope and prudence of standard of a project. Under UT4, the requirement to obtain QCA approval in such circumstances has been removed in favour of an independent audit of the voting process and the provision of an audit certificate.

## 8.2 Expanding the scope of user voting

The QRC does not support Aurizon Network's proposal to expand the matters on which a user vote may be held. The user voting process should be restricted only to assessing the scope of a project. A user vote should not be capable of providing pre-approval of the prudence of standard of a project or the cost allocation principles for a proposed reference tariff in relation to an expansion. These additional matters would require another level of detail to be considered by users, resulting in further complexity in the voting process.

In its submissions, Aurizon Network acknowledged that the information provided to users in relation to the voting process is already insufficient. Adding an additional level of complexity by widening the breadth of the matters which may be considered by a user vote will only add to this existing concern.

## 8.3 Improving the level of information provided to users

Under UT3, users entitled to take part in the voting process receive project information through the CRIMP. The CRIMP is an overall planning document identifying the medium term pathway for rail developments, as well as some limited information in relation to specific projects.

Under UT4, Aurizon Network has proposed that the CRIMP framework, in respect of user voting, be replaced with the supply of working papers addressing specific projects. The QRC supports this change.

As identified by Aurizon Network in its submissions, the main concern of the industry in respect of the UT3 voting framework is the lack of information that is historically provided to users in relation to a given project on which those users are requested to vote upon. The provision of information through the CRIMP process has failed to ensure the provision of sufficient information to allow users to make informed decisions. To overcome this problem, the QRC supports the concept of providing users with working papers which are required to address specific criteria. The QRC also considers that users should be provided with the ability to request additional information from Aurizon Network during the voting process. This will allow users to obtain all necessary information to facilitate informed decision making.

## 8.4 'No' votes

The QRC supports the requirement for a user to provide reasons as to why a project is not supported. The QRC agrees this will equip Aurizon Network with information allowing

it to address user concerns in relation to a specific project. Increased sharing of information through the user voting process will assist the further development and improvement of relevant projects.

However, the QRC does not believe the requirement to provide reasons supporting a 'no' vote should impact the validity of that vote. Affording Aurizon Network the ability to exclude a 'no' vote merely because the reasons provided "cannot reasonably be regarded as appropriate grounds" for that vote, affords Aurizon Network too much discretion. The standard of "appropriate grounds" is vague and ambiguous.

The QRC supports the reinstatement of the UT3 provision in relation to excluding votes. Clause 3.2.2(e) of Schedule A under UT3 provided that a vote could only be excluded with QCA approval. The QCR considers this provision provides a more reasonable safeguard of the votes of a user.

## **8.5 Disagreements regarding entitlement to vote**

The QRC disagrees with Aurizon Network's proposal under UT4 to remove the QCA's involvement in deciding whether a user is entitled to vote in the case of a disagreement. Allowing Aurizon Network an unchecked ability to exclude certain persons from the voting process is unreasonable. This provides Aurizon Network with the ability to manipulate user voting.

## **8.6 Pre-approval of a project**

The QRC considers that the requirement for QCA pre-approval following a successful user vote should be reinstated. The independent audit of the voting process is not an adequate safeguard to ensure Aurizon Network has properly complied with the voting process. Although the audit is stated to be 'independent', Aurizon Network has a significant involvement. For example, where a user has a concern regarding the voting process, this concern must be reported to Aurizon Network who is then required to communicate that concern to the auditor.

Aurizon Network also has the ability to remedy any flaws in the voting process as they arise in order to achieve 'substantial compliance' with the voting procedure. Aurizon Network is not required to repeat a vote where it is considered that remedying a flaw would not change the outcome of the vote. From these provisions, it is unclear who decides whether 'substantial compliance' has been achieved or whether remedying a flaw would not be expected to change the outcome of the vote. The QRC is not convinced that the auditing process is truly transparent or independent. For these reasons, the QRC does not consider the audit process to be an adequate safeguard of the user voting process. The requirement for QCA approval should be reinstated.

# Part 9 – Connecting Infrastructure

## 1 Overview

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While the QRC has some reservations about the suitability of the Standard Rail Connection Agreement for more complex connections, given how recently the QCA considered the Standard Rail Connection Agreement, the QRC does not have any comments on the Standard Rail Connection Agreement included in UT4.

The QRC has serious concerns however with the effectiveness of Part 9 of UT4. The QRC has proposed substantial changes to that Part. Those changes can be found at the Schedule titled “Part 9 – Connecting Infrastructure” (**Mark-up**).

## 2 Who should have an entitlement to connect private infrastructure

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Part 9 of UT4 only permits a private infrastructure owner to attach private infrastructure to rail infrastructure where the private infrastructure owner is an access seeker. This is an unnecessary limitation. Connections should be permitted by all parties who are able to comply with certain rules and comply with the Standard Rail Connection Agreement. The QRC have therefore proposed that Part 9 apply to access seekers and third parties.

By way of example, if Aurizon Network’s drafting of Part 9 were maintained it would not be feasible for a Galilee infrastructure solution to connect to the Central Queensland Network to the extent that infrastructure were owned by a third party infrastructure company. While it may be in Aurizon Network’s interests to minimise the ability for others to develop rail infrastructure it is not in the public interest.

In addition, if Aurizon Network’s drafting of Part 9 and the definition of access seeker were maintained, a train operator needing to connect a new maintenance or provisioning facility would not be afforded the protections of the Undertaking. In this circumstance Aurizon Network could act in a manner that preferred its related party interests.

If third parties were permitted to connect to the rail infrastructure it would not do away with the need for an access seeker to enter into an access agreement in respect of the rail infrastructure. Therefore Aurizon Network would not seem exposed if connections were open to all parties (and not just access seekers).

## 3 Entering into agreements for the Connection

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Part 9 is drafted in an ambiguous way. It provides that provided certain conditions are met Aurizon Network will consent to the connection. The QRC suggests that this should be framed as an obligation on Aurizon Network to negotiate.

Further, a number of the conditions which can give rise to Aurizon Network refusing consent are matters already covered by the Standard Rail Connection Agreement. The list of these conditions can be substantially reduced.

Most importantly, Part 9 does not specify how Aurizon Network is to provide its consent to a connection. Part 9 leaves it open for Aurizon Network to require agreements in addition to a connection agreement and construction agreement.

Ambiguity in the agreements required to effect a connection will result in protracted negotiations and defeat the purpose of developing a Standard Rail Connection Agreement.

The QRC considers that Part 9 should be reframed to make it clear that to effect a connection the parties are to enter into a connection agreement and construction agreement (other than where Aurizon Network requires construction of the connecting infrastructure to be undertaken by the private infrastructure owner). Furthermore Part 9 should provide that Aurizon Network is obliged to enter into the Standard Rail Connection Agreement and a construction agreement (even if the terms are determined by an expert).

UT3 acknowledged that Aurizon Network would be responsible for any loss suffered by a party where Aurizon Network unreasonably delayed entering into a connection agreement. Aurizon Network removed this provision for UT4. It should be reinstated as it is an important mechanism to prevent Aurizon Network from delaying entry into an agreement.

## 4 Modifications impacting private infrastructure capacity

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Part 9 should also include an obligation on Aurizon Network to consult with a private infrastructure owner/operator where Aurizon Network proposes to modify its rail infrastructure and the various operating rules and assumptions in a way that may require changes to the private infrastructure in order for the access holders using the private infrastructure to continue to have sufficient capacity on the private infrastructure to utilise the equivalent access rights on the rail infrastructure.

For example, if private infrastructure is designed and constructed in a manner to deliver capacity equivalent to the capacity sought by the user of the private infrastructure on the rail infrastructure (taking into account operating assumptions relevant at that time) a change in the operating assumptions on the rail infrastructure could result in the private infrastructure no longer being able to deliver sufficient capacity for the user to effectively use its access rights on the rail infrastructure.

The above example could have substantial implications were the private infrastructure is developed by third parties and has multiple users (eg Galilee or Surat rail connections to the CQC).

## 5 Disputes

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Part 9 should also include a right for Aurizon Network or the third party to refer the negotiations of a connection agreement or construction agreement to dispute. This is a particularly important right because little guidance is provided on the terms of the construction agreement and the scope for disagreement is significant.

An alternative (which would be preferable) is that UT4 should be amended to include a standard construction agreement for connecting infrastructure. This would assist to reduce the scope for delay.

## 6 An alternative proposal for dealing with the costs of connecting infrastructure

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For tax and other reasons, it would be preferable if the capital and operating and maintenance charges were charged through access charges. If this were to be pursued:

- (a) Aurizon Network could be obliged to fund connecting infrastructure costs (which are typically not significant costs);
- (b) Aurizon Network would recover such capital costs as access charges; and
- (c) there would be no need for a construction agreement. This has a significant benefit of reducing the administrative burden for Aurizon Network and the private infrastructure owners.

## Part 10 – Reporting and auditing

### 1 Overview

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This part of the submission outlines the QRC’s position in relation to Aurizon Network’s reporting and auditing obligations under UT4, as captured in UT4 Part 10 (**Part 10**).

In summary, the QRC proposes the following key amendments to the reporting and auditing framework:

- 1 The reinstatement of the operational reporting regime contained in UT3. The QRC seeks to maintain Aurizon Network’s obligation to provide quarterly operational reports. The QRC does not support the relaxation of Aurizon Network’s operational reporting requirements as contemplated by UT4;
- 2 The reinstatement of the ability for the QCA to publically disclose “Below Rail” details of access agreements (subject to the exclusion of nominated confidential information) contained in UT3. The QRC considers the public disclosure of this information to be a significant mechanism for providing access seekers and access holders with confidence about non-discriminatory treatment by Aurizon Network;
- 3 The inclusion of a requirement for the format of all reports required under UT4 to be approved by the QCA in advance;
- 4 The inclusion of a mandatory annual audit of Aurizon Network’s reporting obligations under UT4 and a separate ability for the QCA to require an audit of those obligations as required. The QRC considers that the benefits of increased transparency arising from such audits will outweigh any incremental increase in Aurizon Network’s auditing costs;
- 5 The inclusion of a mandatory annual audit of Aurizon Network’s compliance with its ringfencing obligations under UT4 Part 3 (**Part 3**) and a separate ability for the QCA to require an audit of those obligations as required. This is discussed further in the QRC’s submission in relation to Part 3;
- 6 The ability for Aurizon Network to recover its costs of undertaking a compliance audit to be subject to QCA approval. The QRC considers that QCA approval should be required to ensure that Aurizon Network’s cost recovery is reasonable in the circumstances; and
- 7 The reinstatement of QCA involvement in the appointment of auditors. The QCA has been involved in appointing auditors under rail undertakings in Queensland since 2001. The QRC does not consider that there is any basis for removing the QCA’s involvement in this process under UT4. In fact, the QRC considers that to ensure impartiality it is necessary for the QCA to engage the auditor.

The mark-up of Part 10 which reflects the QRC’s proposed amendments is set out separately in the QRC’s mark-ups (**Mark-up**).

### 2 Reporting

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This section clarifies the QRC’s position in relation to certain aspects of Aurizon Network’s UT4 reporting obligations but does not seek to limit the QRC’s Mark-up.

## 2.1 Quarterly operational performance reporting

The obligation for Aurizon Network to provide quarterly operational performance reports in UT3 has been relaxed in UT4 to require annual reporting only. The QRC does not support this relaxation and seeks the reinstatement of the quarterly reporting obligations contained in UT3.

Aurizon Network has sought to explain the relaxation in its operational reporting obligations in UT4 on the basis that, as a subsidiary of AHL, the release of its performance information should be “coordinated” with AHL’s ASX reporting policies (that is, AHL’s annual reports). Aurizon Network contends that the publication of performance reports at any other time is problematic because they “*will be relied upon by investors and market analysts in assessing firm value and making investment recommendations*”. Aurizon Network further says that the costs involved in preparing operational reports on a quarterly basis are not justified.

Although the QRC recognises the importance of streamlined corporate governance, it does not consider a shift to annual reporting to be justified because:

- (a) like all publically listed entities, AHL is subject to ASX interim reporting requirements, not only annual reporting;
- (b) to the extent that operational performance information is considered to be market sensitive, AHL would be required to disclose that information under the ASX continuous disclosure requirements in any case; and
- (c) it seems unlikely that the incremental costs for Aurizon Network to present operational information in a particular format on a quarterly basis would be significant given the need for AHL to manage and assess network performance on an ongoing basis to ensure compliance with the ASX continuous disclosure regime.

The QRC considers that the combination of ASX continuous disclosure and interim reporting requirements on AHL supports the argument that operational information can and should be publicly disclosed more frequently than annually.

## 2.2 Public disclosure of access agreements

UT4 retains the obligation of Aurizon Network, upon request by the QCA, to provide details of the “Below Rail” aspects of a signed access agreement (including access charges) in order for the QCA to satisfy itself that the agreement does not offend the QCA Act or UT4. However, UT4 significantly changes QCA’s entitlement to publically publish the “Below Rail” aspects of an access agreement by requiring the prior written consent of the parties to the access agreement. The QRC seeks the reinstatement of the disclosure regime contained in UT3 which enabled the QCA to publish details of the “Below Rail” aspects other than for parts nominated by a party (and accepted by the QCA) as containing confidential information.

Aurizon Network’s justification for the change in disclosure requirements is that it considers the publication of access agreement details to discourage “innovation” in negotiations and, in particular, to dissuade Aurizon Network from varying its standard terms. Aurizon Network also contends that the ringfencing obligations in Part 3 are sufficient in themselves to ensure that Aurizon Network does not unfairly discriminate between access seekers.

The QRC does not support Aurizon Network’s shift towards the prioritisation of “innovative” negotiations. The QRC considers the public disclosure of access agreement details to be a significant mechanism for providing access seekers and access holders with confidence about non-discriminatory treatment by Aurizon Network. Further, and as identified in the Part 3 submissions, the QRC has a number of concerns regarding the

efficacy of the UT4 ringfencing obligations. Accordingly, the QCA’s right to publish the “Below Rail” aspects of access agreements should be retained.

## 2.3 Format of reports

The QRC supports the inclusion of a requirement in UT4 for the format of all reports required under UT4 to be approved by the QCA in advance. This requirement existed in part under the UT3 and will ensure consistency of reporting for the term of UT4.

## 3 Auditing

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This section clarifies the QRC’s position in relation to certain aspects of the UT4 auditing requirements but does not seek to limit the QRC’s Mark-up.

### 3.1 Mandatory annual audits: reporting obligations and conflicts

The accountability and compliance framework proposed by Aurizon Network under UT4 removes all ongoing obligations for annual audits contained in UT3. Instead, audits are triggered under UT4 at the request of the QCA. Aurizon Network considers that the *“the ability for the QCA to request an audit where it considers [it] is justified ... reflects a more reasonable balance in the interests of access seekers and Aurizon Network given the costs involved in auditing.”*

To provide increased transparency and preserve access holder confidence, the QRC proposes that annual audits of Aurizon Network’s reporting and ringfencing obligations (discussed further in the Part 3 submission) be undertaken under UT4. The QRC considers that the benefits of increased transparency will outweigh any incremental increase in Aurizon Network’s auditing costs.

### 3.2 Recovery of compliance audit costs

Aurizon Network is seeking to recover its costs of completing compliance audits undertaken on the instruction of the QCA.

As is noted in item 3.3 below, the QRC suggests that the auditor be engaged by the QCA. The QRC suggests that the costs of the auditor be paid for by the QCA and those costs recovered through the QCA levy.

### 3.3 QCA appointment of auditors

The requirement for QCA approval of the Aurizon Network selected auditor (or auditors) has been omitted from UT4. Aurizon Network argues that such a requirement constitutes an unwarranted intervention by the QCA given the other requirements the auditor must satisfy to comply with UT4.

The QRC does not consider that there is any basis to exclude QCA involvement from the appointment of auditors in UT4. The QRC instead proposes that auditors should be engaged directly by the QCA. While Aurizon Network has proposed that an auditor engaged by it would owe a duty to the QCA and to Aurizon Network, greater impartiality is achieved if the auditor is engaged by the QCA. The QRC finally notes that it is not appropriate for the auditor to have any duty to Aurizon Network.

# Part 11 – Dispute resolution

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to the dispute resolution framework under UT4, as captured in UT4 Part 11 (**Part 11**).

In summary, the QRC proposes the following key amendments to the dispute resolution framework:

- 1 The broadening of the application of the dispute resolution procedure set out at Part 11. The QRC considers that dispute resolution is an integral component of the accountability of Aurizon Network to users and it is imperative that dispute resolution applies across the board;
- 2 The reinstatement of the requirement under UT3 for all disputes to be referred in the first instance to the chief executive. The QRC considers the initial referral of a dispute to the respective chief executives is commercially sensible and encourages the parties to resolve the dispute without the need to resort to more formal dispute resolution mechanisms;
- 3 The reinstatement of the requirement under UT3 for the parties to agree to refer a dispute to mediation rather than allowing either party to refer the dispute. The QRC considers allowing one party to refer a dispute to mediation without the other party’s consent undermines the value of the pre-mediation dispute resolution steps;
- 4 The softening of the requirement to spend 4 months attempting to mediate a dispute. The QRC considers that in certain circumstances a dispute should be able to be escalated prior the expiry of 4 months, for example, where one party fails to participate in a mediation in good faith;
- 5 The removal of the procedure for arbitration from UT4. Rather, the QRC considers that the procedure for arbitration should be that established under the QCA Act to prevent any inconsistency;
- 6 The reinstatement of the requirement under UT3 that any costs imposed by the safety regulator be borne by the parties “in such proportion as the QCA determines”;
- 7 The removal of the prohibition on the QCA from making a determination that could prejudice the land or rail infrastructure tenure of Aurizon Network. The QRC considers that the prohibition is unreasonable as it is based on a mere possibility and no concession is made for any potential fault of Aurizon Network. Further, the infrastructure lease is not a public document and we understand that the QCA has not received access to the infrastructure lease;
- 8 The requirement that where a party unreasonably causes delay to a project or delays or frustrates the enforcement of a QCA decision, that party be liable for the costs of such delay or frustration. The QRC considers such requirements will provide an incentive for both parties to act constructively and expeditiously during the dispute resolution process; and
- 9 Removal of the extensive list of considerations upon which a decision of the QCA must be made in favour for a requirement for the QCA to make a decision which is not inconsistent with the QCA Act, *Judicial Review Act 1991* (Qld) or any applicable common law rules of natural justice. The QRC considers this will

provide increased certainty and prevent the risk of inconsistency with the established laws.

The mark-up of Part 11 which reflects the amendments proposed by the QRC are set out separately in the mark-up document titled “Part 11 – Dispute resolution” (**Mark-up**).

## 2 Dispute Resolution

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This section clarifies the QRC’s position in relation to certain aspects of the UT4 dispute resolution framework but does not seek to limit the QRC’s Mark-up.

### 2.1 Disputes

Under UT3, the dispute resolution process applied generally in respect of the operation of, or anything required to be done under the undertaking. UT4 changes the application of the dispute resolution process, restricting it to matters expressly required by the undertaking to be resolved in accordance with the dispute resolution process set out in Part 11.

The QRC considers that the UT4 drafting unreasonably restricts the disputes which may be referred for resolution under that part. The QRC submits that Part 11 should be expanded so that it applies to a wider range of disputes.

Dispute resolution is an integral component of the accountability of Aurizon Network to users. It is therefore imperative that the dispute resolution process apply to a broad range of matters which may arise under the Undertaking.

Broadening the application of Part 11 is particularly required due to the decision of Aurizon Network to remove the references to the ability to refer a matter to dispute resolution throughout the remainder of UT4. For example, the specific dispute resolution provisions have been removed from Part 2 (Intent and Scope) and Part 4 (Negotiation Framework). Aurizon Network contends that these clauses have been removed so that dispute resolution can be dealt with uniformly under Part 11. For this purpose to be achieved, it is essential that the application of Part 11 is broad enough to clearly encompass any disputes arising under those and other applicable Parts.

### 2.2 Chief executive resolution and mediation

UT3 required all disputes to be referred in the first instance to the chief executive, unless otherwise agreed between the parties. This requirement has been amended under UT4 to provide that a dispute can be referred directly to expert determination in circumstances where the Undertaking specifies the dispute must be subject to expert determination.

The QRC’s view is that all disputes should be referred in the first instance to the relevant chief executives for resolution, regardless of whether the Undertaking requires expert determination. Initial referral to the respective chief executives is commercially sensible and encourages the parties to resolve the dispute prior to formal escalation.

Aurizon Network has also removed the UT3 requirement for the parties to agree to refer a dispute to mediation. Under UT4, either party can refer a dispute to mediation, whether or not the other party agrees. The QRC considers that the requirement for agreement between the parties should be reinstated. An individual party should not have the ability to refer a dispute to mediation without the prior written agreement of the other party to the dispute. To do so would undermine the purpose of the pre-mediation provisions of UT4.

## 2.3 Mediation

The QRC considers that as drafted, the approach to mediation is inflexible and inefficient because a dispute may not be escalated unless it is unresolved 4 months after referral to mediation. This means that regardless of whether the mediation is making any leeway in terms of resolving the dispute, the dispute cannot be referred past that stage until the expiry of 4 months. The QRC considers this requirement to spend an arbitrary 4 month period attempting to mediate the dispute is inefficient and fails to promote the timely resolution of matters.

The QRC considers it more appropriate for a dispute to be escalated after referral to mediation on the earlier of any of the following occurring:

- the mediator considers the parties cannot achieve a mediated resolution;
- the mediator considers that a party to the mediation fails to participate in good faith; or
- mediation fails to resolve the dispute within 4 months of referral.

The escalation of the dispute in such circumstances will prevent wasting time trying to mediate a dispute where it is evident that one party, or both parties, have no interest in achieving a resolution by those means.

## 2.4 Determination by the QCA

The QRC submits that it is inappropriate for UT4 to detail the procedure for arbitration by the QCA. While it is appropriate to set out procedures applicable to expert determination, the QCA Act establishes the process for arbitration. Therefore, it is unnecessary to specify an arbitration procedure in UT4 and doing so may lead to inconsistency.

## 2.5 Costs of a safety regulator

UT3 required any costs imposed by the safety regulator to be borne by the parties “in such proportion as the QCA determines”. Aurizon Network has adjusted this provision under UT4 to require the parties to equally share such costs. The QRC considers that the requirement for the QCA to determine the costs owed by each party should be reinstated. The current UT4 provision operates arbitrarily by requiring that costs be borne equally, potentially resulting in commercial imbalance when an individual party requests the QCA to seek the advice of the safety regulator.

## 2.6 Prejudice to the land or rail infrastructure tenure of Aurizon Network

UT4 contains a new provision which prohibits the QCA from making a determination that could prejudice the land or rail infrastructure tenure of Aurizon Network. The QRC considers this restriction is unreasonable and should be removed because:

- the prohibition is on a mere possibility; and
- no concession is made for any potential fault of Aurizon Network.

The use of ‘could’ results in a prohibition of a mere possibility, as opposed to a certain outcome or even a reasonable likelihood of such an outcome. The prohibition of a mere possibility may cause uncertainty for both industry and Aurizon Network as to what amounts to prejudice to the tenure. This not conducive to an efficient dispute resolution framework.

The prohibition also does not account for any potential fault on the part of Aurizon Network. As drafted, Aurizon Network could feasibly contravene the Undertaking or the QCA Act giving rise to a dispute, yet the other party to the dispute may be left without an

acceptable QCA determination because that determination may affect Aurizon Network's land or rail infrastructure tenure.

Further, Aurizon Network's infrastructure lease is not a public document. The only party that would seem to be in a position to be able to make meaningful comment on whether the lease could be breached is Aurizon Network.

## 2.7 Time

The QRC considers that the dispute resolution procedure should provide for both parties to use reasonable endeavours to resolve a dispute in a way which does not unreasonably impact a project or mine development. Further, in circumstances where a party's unreasonable delay results in delays to a project or mine development, that party should be responsible for bearing the cost of the delay.

These provisions will provide an incentive for both parties to act constructively during the dispute resolution process. There will also be an incentive to resolve disputes as expeditiously as possible such that little delay, if any, flows on to the related projects.

The QRC considers that analogous provisions should also be included in respect of the enforcement of any decision by the QCA. Again, cost implications should be imposed for any delay or frustration to the enforcement of a QCA decision caused by a party acting unreasonably. This will assist in ensuring the prompt enforcement of a QCA decision.

## 2.8 QCA decision-making

Clause 11.2 under the UT4 provides for an extensive list of considerations which restrict the decision-making power of the QCA. The QRC considers this extensive list unnecessary. Rather, the QRC considers that the UT4 should require the QCA to make a decision which is not inconsistent with:

- the QCA Act;
- the *Judicial Review Act 1991* (Qld); or
- any of the common law rules of natural justice to the extent applicable.

Clarifying that the QCA is subject to the above established laws, rather than attempting to relist the content of such laws, provides for more certainty and prevents the risk of inconsistency or inaccuracy.

# Schedule E – Regulatory Asset Base

**Note:** Clause references in this section refer to the clause references in the QRC’s mark-up titled “Schedule E – Regulatory Asset Base”.

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to Aurizon Network’s obligations with respect to the regulatory asset base (**RAB**) under UT4, as captured in UT4 Schedule E.

In summary, the QRC has the following key comments on Schedule E:

- In relation to rolling forward the asset values in the RAB, the QRC accepts Aurizon Network’s proposal to deduct sales proceeds where an asset is disposed of for a lesser value, provided that the amount deducted is not less than market value. However, the QRC does not support Aurizon Network’s proposal to retain 50% of any profits from a sale of an asset, or the requirement for QCA to accept any amount Aurizon Network proposes to deduct from the RAB on this basis. The QRC also requires the QCA to assess reasonableness in respect of equity raising costs.
- In relation to adjustments to the RAB, Aurizon Network has removed a number of the bases on which a reduction may take place. The QRC requires the reinstatement of the ability to reduce the RAB on the basis of reduction in demand, the possibility of bypass, and a condition based assessment illustrating excessive deterioration of the network. Whilst the QRC would support additional drafting to clarify the requirement of a condition based assessment, it considers a conditions based assessment is necessary to ensure Aurizon Network does not collect a maintenance allowance without completing the relevant maintenance.
- The QRC also considers the following UT3 requirements should be reinstated:
  - the requirement for Aurizon Network to separately report in relation to each group of asset subject to a different reference tariff;
  - the restriction of user voting only to the prudence of scope; and
  - the consistency of expenditure with an asset management plan being a mere factor for the QCA to consider rather than a determinative consideration.

The mark-up of Schedule E which reflects the amendments proposed by QRC are set out separately in the mark-up document titled “Schedule E – Regulatory Asset Base” (**Mark-up**).

## 2 Clause 1 of Schedule E: Maintenance of the Regulatory Asset Base

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### 2.1 Clause 1.1 of Schedule E: Roll forward principles

Aurizon Network proposes that, where an asset is disposed of for less than the value in the RAB, the net value of proceeds will be deducted from the RAB. Under UT3, the “value of asset disposals” was deducted from the RAB. It was not clear under UT3 whether this amount was the disposal proceeds or the written down value of the assets. Under ARTC’s Hunter Valley Access Undertaking, the amount removed from the RAB is the written down value of the assets. This ensures that the RAB does not reflect values for assets which are no longer in use. Despite this, the QRC accepts Aurizon Network’s proposed approach (deduction of the sales proceeds) but proposes drafting to ensure that the value deducted is no less than market value arising from a prudent sale process. This is considered particularly important for asset transfers within the Aurizon group. The QRC sees no justification for Aurizon Network’s proposal to retain 50% of any profits on sales yielding more than the RAB value.

The QRC has deleted Aurizon Network’s proposed drafting which sought to ensure that the QCA is bound to accept the amount which Aurizon Network proposes to deduct from the RAB.

### 2.2 Clause 1.2 of Schedule E: Adjusting the value of assets in the Regulatory Asset Base

#### (a) Clause 1.2(b) of Schedule E: Equity raising costs

The QRC relies on the QCA to determine whether the addition of equity raising costs to the RAB (Schedule E, 1.2(b)), and the proposed approach to determining the value to be added (Schedule E, 1.5) are reasonable.

To the extent that a process exists for adding these costs to the RAB, the Undertaking should ensure that Aurizon Network similarly seeks to add such a cost to the value of SUFA-funded assets.

#### (b) Clause 1.2(c) of Schedule E: Reduction of RAB:

The following bases on which the RAB could be reduced under schedule A of UT3 should be reinstated in UT4:

- 1.4(b) circumstances arise in the future where demand has deteriorated to such an extent that regulated prices on an unoptimised asset would result in a further decline in demand;
- 1.4(c) it becomes clear that there is a possibility of actual (not hypothetical) bypass; or
- 1.4(d) an end period assessment conducted in accordance with clause 5 of Schedule A of UT3 determines that the rail infrastructure has deteriorated by more than would have been the case had good operating practice and prudent and effective maintenance and asset replacement policies and practices been pursued.

1 Reduction in demand and bypass:

Aurizon Network suggests (10.8.2.2 of Volume 2) that a reduction in demand or a possibility of bypass can be addressed through the annual review of reference tariffs under Schedule F. Our understanding of the adjustments carried out in this process is that they are relatively mechanical. For example, the review is

not intended to reopen elements of System Allowable Revenue (**SAR**) other than those for which an adjustment is specifically allowed. It is not clear to us that it would be open to a stakeholder to suggest a revision to SAR on the basis of, for example, the possibility of bypass, nor is it clear to us that it would be open to the QCA to accept such a suggestion as part of the Schedule F process. We prefer that the matters previously set out in Schedule A of UT3 be retained, or alternatively be explicitly set out in Schedule F as matters which must be considered in the annual review of reference tariffs.

## 2 Condition based assessment:

The condition based assessment, and Clause 1.4(e) of Schedule A of UT3, which allowed for a reduction in the RAB where the condition of the network deteriorated excessively, was a sensible addition to the UT3. In the absence of such a clause, Aurizon Network may collect its maintenance allowance, under-maintain the network (acknowledging that safety and other considerations provide practical limits to this risk) and retain the unspent allowance. A subsequent undertaking which includes a maintenance allowance based on the prudent scope required during the next period will include an allowance for the same work, resulting in double payment.

Aurizon Network proposes to delete this requirement from UT4, without providing any alternative suggestion to address the concern described above (such as a deduction from the maintenance allowance for approved scope not completed). Aurizon Network's basis for deleting the condition based assessment is:

- Difficult in interpreting the requirement: the QRC would support additional drafting which clarifies the clause.
- Constraints: Aurizon Network claims that the provision is not necessary because of the level of QCA involvement in approving and monitoring Aurizon Network's maintenance activities. This seems to overlook the fundamental problem, which is that Aurizon Network may not complete the maintenance which the QCA has approved, and there is nothing that the QCA could do about that. In the event that Aurizon Network did complete all of the approved scope, we would consider it very unlikely that the QCA would seek to invoke Clause 1.4(e) of Schedule A, as this would require that the maintenance plans approved by the QCA in the course of approving the undertaking were not prudent or effective.
- Necessity: Aurizon Network claims that other considerations (safety, vertical integration, contracts, immediacy of impacts) provide an effective disincentive to under-maintaining the assets. These factors do place a practical constraint on the extent of the problem, but, as the QCA has previously found in regard to ballast fouling, do not eliminate the risk.
- Precedent: Aurizon Network is not aware of other regulated businesses which have such a condition. This should not preclude the inclusion of this sensible provision in Aurizon Network's undertaking.

## 2.3 Clause 1.4 of Schedule E: Regulatory Asset Base roll forward report to the QCA

"Separately reported for each coal system" – in UT3 Aurizon Network had to separate each group of assets which was subject to a different reference tariff. This should be reinstated. In addition, Aurizon Network should be obliged to report separately on user

funded assets and any expansion group that would pay a premium in accordance with the QRC’s proposed socialisation principles (please refer to the QCA’s pricing principles paper).

## **2.4 Clause 1.5 of Schedule E: Equity raising costs**

The QRC relies on the QCA to determine whether the addition of equity raising costs to the RAB (Schedule E, 1.2(b)), and the proposed approach to determining the value to be added (Schedule E, 1.5) are reasonable. We also rely on the QCA to ensure that there is no double counting between equity raising cost allowances and corporate costs (e.g. corporate costs of investor relations, road-shows etc.).

## **3 Clause 2 of Schedule E: Acceptance of capital expenditure into the Regulatory Asset Base by the QCA**

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The restriction of allowing a user vote only in respect of the prudence of scope of works under UT3 should be reinstated. Under UT4, Aurizon Network has sought to expand a user vote to cover the prudence of standard of works. The QRC does not support this change for the reasons set out in the QRC’s submission in respect of Part 8. Accordingly, any reference to a user vote in respect of the standard of works under Schedule E has been removed in the QRC’s mark-up.

## **4 Clause 3 of Schedule E: Prudence of Scope**

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The QRC does not agree that the QCA must accept the scope of a capital expenditure project as prudent if, for asset replacement expenditure, it is in accordance with the asset management plan (Schedule E, 3.2(a)(i)).

An asset management plan is a high level document which, by itself, does not contain sufficient detail to determine whether the scope of a capital expenditure is prudent. Rather, an asset management plan should only be one of the factors the QCA considers in determining prudence of scope.

## **5 Clause 4 of Schedule E: Prudence of Standard**

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The QRC does not agree that the QCA must accept the standard of a capital expenditure project as prudent if, for Asset Replacement Expenditure, it is in accordance with the asset management plan (Schedule E, 4.2(a) and (b)).

As discussed above, an asset management plan should only be one of the factors the QCA considers in determining prudence of standard.

# Schedule F – Reference tariff

**Note:** Clause references in this section refer to the clause references in the QRC’s mark-up titled “Schedule F – Reference tariff”.

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to Aurizon Network’s obligations with respect to reference tariffs under UT4, as captured in UT4 Schedule F.

In summary, the QRC has the following key comments on Schedule F:

- Whilst the QRC supports the majority of Aurizon Network’s proposal for the pricing of cross system train services, the QRC considers that the UT3 position in respect of AT5 and EC should be reinstated.
- In relation to the ToP framework, the QRC agrees that the various generations of take or pay lead to inequities between access holders. However, the QRC does not support the prioritisation of UT1 access holders. Rather, the QRC seeks to move to full contractual accountability over time to address all inequities. In relation to Aurizon Network’s specific proposals with respect to the ToP framework, the QRC:
  - agrees with the Gladstone area ToP arrangement;
  - does not agree with the proposal to set a higher forecast for Wiggins Island;
  - agrees with the proposal for mine capping, but does not agree with the proposal for operator capping; and
  - does not agree with extending the list of matters excluded from constituting ‘Aurizon Network Cause’ for the purpose of determining when ToP is not payable.

The QRC also proposes a new requirement to apply a premium tariff in the case of ToP for expansion users.

- The QRC does not agree with the application of a revenue smoothing methodology to the derivation of reference tariffs over the regulatory period. The QRC intends to work with Aurizon Network to seek to develop an approach in which volumes, capital and the scope of maintenance and the budget is reviewed ahead of each year.
- In relation to the adjustments to SAR, the QRC disagrees with the Aurizon Network’s proposal with respect to:
  - charges from electricity retailers for environmental initiatives;
  - audit costs; and
  - the recovery of forecast less actual AT1 revenue.
- The QCR considers the QCA should not be limited from seeking whatever input it considers relevant when considering revenue adjustment amounts.
- The QCR proposes a number of clarifications with respect to calculation of access charges.

- The QCR opposes the increment proposed by Aurizon Network as it has failed to develop reasonable incentive mechanisms.
- The QCR supports the recovery of revenue adjustment amounts through an adjustment charge and would like to explore the feasibility of creating such an adjustment.
- The QCR supports an inclusion of the ability for the QCA to develop a reference tariff variation in the event Aurizon Network fails to do so.
- In relation Aurizon Network’s proposal in regard to review events for reference tariffs, the QCR considers the following new review events to be unnecessary:
  - where maintenance costs increase by more than 2.5% due to customer or access holder request; and
  - tendered work exceeds the expected cost and results in an increase of more than 2.5%.
- In relation to system specific information, the QCR requires the inclusion of diesel as ‘Reference Train Services’. The QCR considers the risk and uncertainty created by the proposal to limit ‘Reference Train Services’ to electric trains in the Blackwater (other than Rolleston and Minerva) and Goonyella systems is unacceptable.

The mark-up of Schedule F which reflects the amendments proposed by QRC are set out separately in the mark-up document titled “Schedule F – Reference Tariff” (**Mark-up**).

## 2 Clause 1 of Schedule F: General Provisions

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This section appears generally consistent with UT3, however, due to the addition of Clause 1.3(b)(vii), it appears that a service will only be a reference train service if the capital costs incurred by Aurizon Network in respect of the train service were reflected in the reference tariff. While the principle seems reasonable, there may exceptions:

- some of the capital costs may have been allocated to the calculation of a different reference tariff, for example to reflect a benefit of the capital expenditure to existing access holders.
- Some of the capital costs may have been deemed imprudent and not added to the RAB.

We have proposed appropriate drafting amendments.

### 2.1 Clauses 2.1 – 2.2 of Schedule F: Reference tariff

UT3 (Schedule F, Part B, 2.1.4) requires that, for the purposes of calculating tariffs, the measures of gtk, rtp, ntk, nt and egtk are assessed over a billing period for the relevant train service. UT4 is unclear as to whether these are actual measures, or a set of standard measures based on the reference train that will be used for billing purposes. As the standard access agreements are clear on this point (specifying the use standard weights in some cases, such as for locomotives, and actual weights where available for wagons), it would be helpful if Schedule F referred to the methodologies set out in the Schedule 4 of the agreements.

## 2.2 Clause 2.3 of Schedule F: Cross system train services

Aurizon Network’s proposal for the pricing of cross system train services, and the QRC’s views, are set out below:

Tariff	Aurizon Network UT4 Proposal	UT3	QRC comment
AT1	Origin AT1 for gtk in origin system, destination AT1 for gth in destination system	As per UT4	Support
AT2	AT2 of destination system plus, if using a constrained section of origin system, the AT2 of the origin system	As per UT4	Support
AT3	Origin AT3 for ntk in origin system, destination AT3 for ntk in destination system	Higher of the origin or destination AT3s, applied to all ntk	Support change
AT4	Destination AT4 applied to nts	Higher of the origin or destination AT4s, applied to all nts	Support change
AT5 and EC	Destination system AT5/EC applied to all egtk	Origin AT5/EC for egtk in origin system, destination AT5/EC for egtk in destination system	Do not support change – revert to UT3 terms

## 2.3 Clause 2.4 of Schedule F: Take or Pay (“ToP”)

### Discussion: The current problem:

The QRC agrees with Aurizon Network {in Section 10.6 of Volume 2 of its submission} that the various generations of take or pay lead to inequities between access holders. The QRC is also concerned that the ineffective ToP arrangements which are a feature of all existing generations of access agreements create a risk of over-contracting, and lead to an inappropriate degree of risk sharing.

Some of the current potential inequities include:

- A forecast of low railings, potentially caused by a subset of access holders, will cause higher access charges for all access holders and, if the forecast is achieved, will result in zero collection of take or pay.
- Where there is a substantial shortfall against forecast, UT2 and UT3 access holders will incur larger take or pay liabilities per tonne than UT1 access holders.

- For less substantial shortfalls against forecast (which have a higher probability), UT1 access holders may incur take or pay liabilities, while UT2 and UT3 access holders may incur little, or no, liability.
- UT1 take or pay collection may result in an over-recovery of revenue, leading to a reduction in tariffs for all users in a subsequent year.

The list of potential inequities above is not exhaustive.

### **UT1 Agreements: Are they particularly disadvantaged?**

We note that the key focus of Aurizon Network's submission on ToP is on possible inequitable outcomes for UT1 access holders. Our understanding is that there is just one UT1 access holder, being Aurizon Operations. Our concerns regarding the involvement of Aurizon Corporate in the preparation of the Undertaking are discussed in the section of our submission dealing with Part 3 of UT4.

The QRC does not consider that there is a need to address the potential inequities for the UT1 access holder in priority to other potential inequities. Aurizon Network seeks to demonstrate in Section 10.6.2.3 of Volume 2 of its submission that the UT1 access holder is particularly disadvantaged. The QRC does not consider that the analysis presented by Aurizon Network is correct. In table 17, UT1 ToP is shown as being 40% of the total access charge. This is not consistent with the terms of ToP under UT1, which are 30% of AT3 and AT4, plus a variable ToP charge which applies only where gtps are 90% or less of forecast. It appears that Aurizon Network has included the Variable ToP charge from UT1 in each of the twelve scenarios shown, even though this would not be payable in ten of the twelve cases (as actual volumes are greater than 90% of forecast). The table, and figure 25 {set out in Section 10.6.2.4 of Volume 2 of Aurizon Network's Submission} are therefore misleading. Our calculations indicate that for a forecast of 90% of contract, UT1 and other ToP would be equated, in \$/t terms, at an actual tonnage of 87% of contract (not, as stated by Aurizon Network, at less than 83%). If actual tonnes are 85% of contract with a forecast of 90%, UT2-3 ToP will be around 80% higher than UT1 ToP. However, UT1 ToP is particularly high when low forecasts are set and actual tonnes are close to the forecast.

Based on proposed 2013/14 tariffs for the Goonyella system, we estimate that:

- UT1 ToP is around 24% of the total AT1-AT4 access charge, in cases where the variable ("VTP") charge does not apply (the variable ToP will only apply where volumes are 90% or less of forecast).
- UT2 and UT3 ToP is around 92% of the total access charge, prior to capping (and it is acknowledged that capping will often substantially reduce the final payment).

As was noted above, we understand that inequitable outcomes can impact on the UT1 access holder, but given that this access holder is only ever likely to pay ToP of around 24% of its access charge, we do not consider that this particular inequity needs to be addressed ahead of all others.

Also, we note that it would be open to an access holder to transition to the current standard access agreement at any time. If Aurizon Operations considers itself particularly disadvantaged by the UT1 terms, it may elect to take up this option. We note also that Aurizon Network's proposal to shift a greater proportion of its revenue to AT2 will assist in mitigating the ToP exposures of Aurizon Operations under UT1 agreements.

### **Long term objective: Full ToP**

The QRC has sought to reform take or pay through a strengthening of the contractual commitment over time. Take or pay arrangements are complex, but have strengthened through successive undertakings, as summarised below:

- UT1: 30% of the shortfall on AT3 and AT4, subject to a system trigger test, plus a variable monthly ToP charge if system volumes are less than or equal to 90% of forecast.
- UT2: 100% of the shortfall on AT2, 3 and 4, but only to the extent necessary to collect Aurizon Network's revenue shortfall after first collecting UT1 ToP.
- UT3: Broadly as per UT2, but will update with changes to future undertakings.

The QRC seeks to move to full contractual accountability over time. The QRC will support the removal of the system trigger test and system ToP capping from future undertakings (which will be effective for UT3 and subsequent agreements) at the time when doing so will affect a significant majority of agreements. Implementing these changes prematurely (while a significant proportion of tonnage remains on UT1 and UT2 terms) would create new, substantial inequities.

#### **Current Aurizon Network proposals:**

Aurizon Network has considered, and in some cases proposed, certain departures from the existing approach to ToP for UT4. These are discussed below:

- **Gladstone area ToP {10.6.2.4}**

Aurizon Network proposes that access holders whose agreements specify either a Barney Point or RG Tanna destination should be able to offset a potential ToP liability for one destination using 'over-railings' to the other. The QRC considers this proposal to be reasonable, and for a strict application of the terms of existing contracts in this case to be unreasonable. The QRC accepts that Aurizon Network should, in this case, not be deemed (for the purposes of revenue cap calculations) to have collected the relevant ToP.

- **Capping of UT1 ToP {10.6.3.1}**

Aurizon Network's submission discussed a range of ideas which could address its concerns regarding UT1 ToP. Aurizon Network has not proposed to implement any of the ideas in this section (although it does propose to implement others) at this time. As is discussed above, the QRC does not agree that UT1 access holders are particularly disadvantaged by the current arrangements, and does not support changes to the way in which UT1 ToP operates.

- **Setting of system forecasts {10.6.3.2}**

Aurizon Network's submission discusses the possibility of setting system forecasts at a higher level in order to ensure that ToP triggers in each year. The QRC has considered this option as a method of effectively removing the effect of the system trigger test and accelerating the move to stronger ToP for all access holders. The QRC agrees with Aurizon Network that such a change should not be made. As stated by Aurizon Network {at Section 10.6.3.2 in Volume 2 of its Submission}, "*a change in the basis for setting system volume forecasts that materially altered the take or pay risk profile could expose these parties to liabilities that have not been anticipated*". Despite the views expressed by Aurizon Network in this section, Aurizon Network does propose to set the Wiggins Island forecast at 90% of contract in order to trigger ToP in the Blackwater System. As is discussed below, the QRC does not support this proposal.

- **ToP for expansion users paying a premium tariff:**

The QRC considers that there is an opportunity to take a different approach to setting forecasts, tariffs, and collecting ToP in the case of new access agreements being entered into in regard to an expansion in which the relevant access seekers will pay a differentiated tariff (See our submission on the pricing principles). In this case, there is no need for the tariff and ToP of these users to involve any socialisation or risk sharing with existing users, nor with each other. The Undertaking could provide for the tariff of such a group to be calculated based on the contracted tonnage of the group, while the access

agreements could specify that ToP be levied without a system trigger test and without capping. In this way, each user within the group would pay full ToP (and should receive a rebate if charges in excess of ToP are paid in regard to AT2, 3 or 4). We would propose that such a group move to the then-standard ToP arrangement at the time that the premium tariff ceases to apply.

- **Special proposal for Wiggins Island:**

Aurizon Network proposes to include 90% of the Wiggins Island (“WICET”) contracted volumes in the Blackwater system forecast, regardless of whether this is a realistic forecast. Aurizon Network states {at Section 10.6.3.2 of Volume 2 of its Submission} that *“as the Blackwater annual system forecast would be established on the basis of expected railings to RG Tanna and Barney Point and contractual entitlements for WICET, this will result in the triggering of take or pay in that system as expected utilisation will be lower than the forecast”*. The effects of this proposal will be:

- the system trigger in the Blackwater system will become ineffective (i.e. ToP will nearly always be triggered). This is the stated intent of Aurizon Network’s approach. For the reasons discussed above, the QRC does not support this approach.
- revenue shortfalls are likely to be significant due to the use of inflated forecasts. This will increase the magnitude of UT2 and UT3 ToP collections, because more will need to be paid before capping applies.

Aurizon Network proposes to insulate the UT1 access holder from these impacts by adopting a special treatment for UT1 agreements, which is to adopt a separate take or pay trigger for the UT1 access holder which excludes the WICET volumes. The change will therefore make the system trigger test virtually ineffective for UT2, 3 and 4 access holders, but not for the UT1 access holder. The QRC’s concerns regarding the involvement of Aurizon Corporate in the preparation of the Undertaking are discussed in the QRC’s submission relating to Part 3.

Aurizon Network has also proposed a new provision (Schedule F, Clause 2.4(e)), which allocates the benefit of any ToP reduction due to QR Network Cause to UT1 access agreements ahead of other access agreements of the same operator for the same origin/destination, presumably as part of Aurizon Network’s package of reforms aimed at reducing UT1 ToP.

- **QRC suggested approach for WICET:**

The QRC considers that a realistic forecast of WICET tonnages should be adopted, and that the QRC’s proposed pricing principles (see the QRC’s submissions relating to Part 6) should be applied if this indicates the need for a differentiated tariff. This would involve calculating a WICET tariff for each year based on the forecast WICET tonnages for the year. We note that the QRC’s proposed new approach to ToP for expansions which pay a differentiated tariff will not be able to be applied to WICET as access agreements are already signed. Therefore WICET ToP will be subject to the system trigger test, and may not be collected in some years. Shortfalls against forecast by the WICET group, to the extent not covered by ToP, will therefore need to be collected through the revenue cap mechanism, impacting existing users.

- **ToP capping:**

Any form of ToP capping has the effect of increasing revenue shortfalls (or reducing over-recoveries of revenues), with the effect that future access charges increase relative to the levels which would have applied without capping. ToP capping therefore transfers costs from the access holder which benefits from the cap, to all other access holders. Despite this, the QRC considers that some forms of ToP capping and ToP offsets are justified. Each of the proposed ToP capping mechanisms is discussed below:

- **Mine capping (Schedule F, Clause 2.4(i)).**

Aurizon Network appears to have retained mine capping in a form which is similar to UT3. The QRC considers that allowing ToP to offset between access agreements for the same origin/destination combination is reasonable. We suggest that it would also be reasonable to extend this concept to allow ToP to offset between mines with similar ownership within the same system.

– **Operator capping (Schedule F, Clause 2.4(k)).**

The QRC does not support the proposed operator capping in its current form. The QRC's concerns include:

- This capping would apply to both UT3 and UT4 access agreements. As the ToP reduction does not appear to be credited to a specific access agreement, it is not clear how operators would allocate the saving amongst the operator's customers. Given that haulage agreements for UT3 access agreements are already in place, customers do not have an opportunity to manage this issue through haulage agreements. Therefore, the ToP saving may be a windfall benefit to operators.
- Operator capping appears to favour larger operators over operators with a smaller customer base, and may therefore create a barrier to entry and discourage competition.
- Where the TSEs for one origin/destination are exceeded, it does not appear equitable for a particular customer to benefit from this available ToP offset simply on the basis of a nomination, while other users of the system, and other customers of the same operator, receive no benefit. In fact, where UT2 and UT3 ToP is being collected and is subject to system capping, those paying UT2 and UT3 and which are not benefiting from operating capping will face an increased liability.
- The ability to nominate ToP Groupings as late as May in each year allows groupings to be constructed with the benefit of nearly a full year of actual data. This suggests that the grouping is more of an accounting creation rather than reflecting any operational arrangement.
- For the holder of an end user access agreement to benefit from operator capping, the end user must request that the operator nominate the TSEs of that end user as part of a take or pay grouping. This may limit the flexibility of the end user to vary the nomination of path usages between operators.

Flexible short term transfer mechanisms are a practical way to allow access holders to manage ToP exposures. This approach is preferred to a purely accounting construct such as capping. Transfers promote the efficient use of infrastructure, while capping simply allows liabilities to be offset on paper. ToP offsets may provide a ToP saving to a party which has hoarded capacity, while mitigation of ToP through transfers rewards only those who take steps to make their surplus capacity available to the system. The QRC's views on capacity transfer mechanisms under UT4 are provided in the section of the QRC submission dealing with Part 7.

– **Aurizon Network Cause**

ToP is not payable to the extent that a shortfall in usage of train service entitlements is a result of Aurizon Network Cause. Aurizon Network has substantially extended the list of matters which are excluded from Aurizon Network Cause. Under UT3, Aurizon Network Cause excluded reasons “*in any way attributable to the Access Holder*”. Under UT4, Aurizon Network seeks to exclude causes relating to “*an Access Holder, a Railway Operator or a Railway Operator’s customer*”. This appears to include any access holder, railway operator or customer. Aurizon Network also excludes causes relating to its passenger priority obligations.

The QRC does not agree that an access holder should be liable for ToP where a shortfall is caused by another access holder, a railway operator providing services to other customers, other customers, or by Aurizon Network complying with its passenger priority obligations. Each of these examples appear to be a reasonable excusal for Aurizon Network in the event that Aurizon Network has any exposure for its performance failures (this is provided for in the standard access agreements). However, it is not appropriate for an access holder to pay ToP in these circumstances. Rather, the access holder should receive ToP relief, and Aurizon Network will recover the revenue through the revenue cap mechanisms.

### 3 Clause 3 of Schedule F: Capital Expenditure Carry-Over Account

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We suggest that if the Capital Expenditure Carry-Over Account for 2012/13 is finalised prior to the finalisation of UT4, so that tariffs can be adjusted, then this clause should be deleted.

### 4 Clause 4 of Schedule F: Annual review of reference tariffs

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The following discussion provides background regarding the QRC’s views on various ‘form of regulation’ matters which are raised in Section 10 of Volume 2 of Aurizon Network’s UT4 submission. Following this discussion, specific responses to the clauses as drafted are provided.

**Background: Lack of incentive through successive undertakings:**

Since the introduction of the revenue cap in UT2, the QRC has held strong concerns regarding the lack of exposure which Aurizon Network faces to its own performance. We note that Aurizon Network “*maintains the view that its vertical integration provides a strong commercial incentive to maximise throughput*”, (10.4.2.3 of volume 2 of the UT4 submission) but point out that:

- The incentive created is to maximise the throughput of one operator. On this basis, Aurizon Network’s statement is more concerning than comforting.
- The incentive will be reduced over time to the extent that new above rail contracts of the related operator feature stronger take or pay terms and excuse the operator for throughput shortfalls which have a below rail cause.

The need for an incentive mechanism was recognised in UT3, with Aurizon Network including in the undertaking a commitment to develop and submit a Draft Incentive

Mechanism (**DIM**). Aurizon Network submitted the DIM to the QCA in May 2012. In the QRC's view, the DIM did not comply with the requirements of Clause 2.6 of UT3, provided Aurizon Network with significantly more upside than risk, and would be ineffective in driving performance improvements. Aurizon Network's comments on the feasibility of developing effective incentive mechanisms (10.4.2.2 of Volumes 2) are not encouraging. Aurizon Network suggests that "*many of the issues can be addressed through direct commercial negotiation*". As was discussed in our Part 8 submissions, the concept of 'commercial' negotiation with a monopoly in the absence of effective regulation is flawed, and the experience of the QRC's members leads them to conclude that the negotiation of any important matter with Aurizon Network must be supported by effective dispute resolution processes.

The QRC recognises the complexity involved in developing effective incentive arrangements. Despite this, we consider that this must be achieved in order to promote the economically efficient operation of, and use of, the infrastructure.

The exclusion of AT1 from the revenue cap mechanism has previously been supported by the QRC on the basis of:

- Providing Aurizon Network with some limited incentive; and
- Reflecting that, as Aurizon Network must have some variable costs in its business, a fully fixed revenue stream will actually provide an incentive to reduce throughput.

AT1, and its exclusion from the revenue cap, is important for the above reasons. We do not consider that AT1 is important as a price signal regarding long run maintenance costs (which we understand was the original purpose of AT1). Therefore we support AT1 being set at a level which reflects Aurizon Network's short run variable costs (not limited to maintenance) plus, until effective incentive arrangements are implemented, a small amount above this level to provide Aurizon Network with a limited incentive to maximise volumes.

#### **Aurizon Network's proposal:**

Aurizon Network has not proposed effective incentive mechanisms under UT4, nor has it included its previously proposed DIM in UT4 (other than a non-reciprocal upside for exceeding contracted TSEs).

In regard to AT1, which previously provided some very limited incentive to maximise volumes, Aurizon Network proposes to:

- Adjust SAR ahead of each year, on a basis which is partly variable with forecast volumes, using a Short Run Variable Maintenance Cost Rate. This rate is derived from Aurizon Network's analysis of Aurizon Network's own proposed maintenance forecast. That is, Aurizon Network has proposed a maintenance budget which varies with volumes on a basis determined by Aurizon Network, then used the relationship inherent in its own proposal to establish the formula.
- Recover any shortfall between actual and expected AT1 revenue as part of the revenue cap mechanism.

If we understand the example correctly (Section 10.4.3.1 of Volume 2), this seems to suggest that maintenance costs:

- are around 68% fixed, and 32% variable, with forecast GTks, if the forecast varies ahead of a year; but
- exhibit no variability with actual gtps where actual gtps vary from a revised forecast.

Put another way, the approach assumes that Aurizon Network:

- is capable, until February 28 in each year, of making substantial changes to its maintenance plans for the coming July-June period.
- is completely unable to respond to a change in its environment experienced at any time over the following 16 month period.

Using the example, the increase in forecast gtk's increases the forecast costs (and SAR) by \$9.1m, yet if none of that forecast increase was to eventuate, Aurizon Network still seek to recover all of this \$9.1m. This is presumably on the basis that a higher forecast causes maintenance plans to be adjusted, and none of the additional forecast costs can then be avoided when actual throughput does not increase as expected. We do not consider this to be credible. In particular, it is not credible that:

- Aurizon Network has no costs which vary with actual volumes (rather than forecast volumes) within a twelve month period.
- Having carried out additional maintenance based on a forecast tonnage increase which did not eventuate, there is no saving in maintenance requirements in any subsequent year.

This proposal provides:

- an incentive to maximise forecast tonnes (in order to increase the SAR).
- no incentive to maximise actual tonnes and, to the extent that Aurizon Network has any short term variable costs, whether in maintenance or elsewhere, an incentive (which we acknowledge will be weak) to reduce actual tonnes.

We understand that the examples above could be reversed, such that a reduction in forecast gtps will lead to a reduced SAR, and if actual gtps then exceed the forecast, Aurizon Network will be unable to retain any of the additional AT1 revenue collected as it will effectively be refunded through an adjustment to SAR.

The QRC supports an approach in which the scope of maintenance and the budget is reviewed ahead of each year within the regulatory period. The QRC intends to work with Aurizon Network to seek to develop such an approach. The approach may or may not include a mechanistic approach for adjusting the maintenance budget such as that proposed by Aurizon Network.

In regard to AT1, the QRC considers that this should remain outside the revenue cap, and should, at a minimum, represent some allowance for Aurizon Network's short run variable costs. In addition, unless an appropriate set of incentive mechanisms are included in the final approved undertaking, AT1 should exceed Aurizon Network's short run variable costs in order to provide some limited incentive. Such an incentive would be reciprocal in that Aurizon Network would over-recover its costs when exceeding forecast, and under-recover when falling short of forecast. This incentive would be consistent with the requirements of Clause 2.6 of UT3.

Note: The adjustment in Schedule F, 4.1(b)(iii) appears to operate in the opposite direction to what is intended, as it will reduce the SAR when forecast volumes increase, and vice versa. Also, the methodology involves creating an AT1 SAR, but this is not shown in Schedule F. The methodology for allocating the adjustment between AT1 SAR and AT2-4 SAR is described in Aurizon Network's submission but does not appear in the Undertaking.

#### **Reality check: the risk inherent in a variable AT1**

Aurizon Network is concerned that AT1 exposes the business to volume risk. Aurizon Network's approach to successive undertakings has been to identify and eliminate risks, whether material or otherwise. Aurizon Network has been extremely successful in this process and this success should be reflected in Aurizon Network's WACC.

AT1, to the extent that it exceeds Aurizon Network’s variable costs, is one of the few remaining risks which Aurizon Network faces under UT3. Based on the 2013/14 volumes and on the proposed AT1 and SAR set out in Schedule F of the Undertaking, Aurizon Network will derive only 7.9% of its revenue from AT1. Total revenue for this calculation includes AT1-5 revenue. In the event that volumes were to fall by 10% across all of Central Queensland, Aurizon Network’s revenue would decline by only 0.79% and Aurizon Network would still earn, after revenue cap adjustments, 99.21% of its expected revenue. A shortfall of 10% is substantial, noting that Aurizon Network {at Section 10.6.2.3 of Volume 2 of its Submission} describes the risk of a 7.8% shortfall as being “negligible, without a material exogenous shock”. Where a 10% shortfall in volumes does occur, the 0.79% ‘loss’ of revenue will be offset to the extent that Aurizon Network has short term variable costs, or can identify savings in response to the significant exogenous shock. It appears unlikely that a residual risk exists, and, to the extent that it does, it is:

- minor
- symmetrical
- appropriate, as it will provide some (minimal) incentive to Aurizon Network to maximise volumes.

#### **4.1 Clause 4.1 of Schedule F: Requirement for annual review of reference tariffs**

The QRC does not support applying a revenue smoothing methodology to the derivation of reference tariffs over the regulatory period. Instead the QRC supports an approach in which volumes, capital and the scope of maintenance and the budget is reviewed ahead of each year within the regulatory period. The QRC intends to work with Aurizon Network to seek to develop such an approach. At this stage the QRC does not support the proposed mechanistic adjustment to SAR based on the Short Run Variable Maintenance Cost Rate because:

- Aurizon Network has not demonstrated that the adjustment factor is reasonable.
- The adjustment fails to recognise that any shortfall in throughput in the prior year (relative to the revised forecast prepared ahead of that year) must have resulted in maintenance activities exceeding requirements. Therefore, there should be a reduction in maintenance requirements in the following year.

To support the QRC’s suggestion to calculate annual tariffs rather than smoothed tariffs, the QRC considers that the capital indicator should look forward only one year and include capital expenditure which is expected to be rolled into the RAB in that year. Aurizon Network should supply information to the QCA regarding the details of the capital expenditure expected to be rolled in the RAB in only the following year so that this information can be used to develop a capital indicator. That capital indicator is then capable of being used to assess tariffs on an annual basis.

#### **4.2 Clause 4.2 of Schedule F: System Allowable Revenue**

The method proposed in 4.2(b) for calculating the SAR in regard to cross system train services seems to be inconsistent with the basis on which revenue is derived. The QRC will seek an explanation from Aurizon Network for this proposed approach.

#### **4.3 Clause 4.3 of Schedule F: Calculation of revenue adjustment amounts**

**Calculation of adjusted SAR:**

Under Schedule F of the UT3, a number of adjustments are made to SAR on an annual basis, following the end of the relevant year. Aurizon Network proposes a similar approach under UT4, with most adjustments retained, a number added, and one to be deleted. The QRC's views on each are as follows:

<b>UT4 Ref.</b>	<b>Adjustment</b>	<b>Aurizon Network Proposal</b>	<b>QRC position</b>
4.3(b)(i)	Actual versus forecast MCI	Retain	Agree
4.3(b)(ii)	Actual versus forecast CPI	Retain	Agree
4.3(b)(iii)	Charges from electricity retailers for environmental initiatives	Add new adjustment	Disagree – see below.
4.3(b)(iv)	Actual versus forecast cost of electricity connections	Retain	Agree
4.3(b)(v)	Audit costs	Add new adjustment	Disagree – see below.
4.3(b)(vi)	Rebates	Add new adjustment	Agree
4.3(b)(viii)	Recovery of forecast less actual AT1 revenue	Add new adjustment	Disagree – See section 4
n/a	Actual versus forecast cost of electricity	Delete	Agree subject to appropriate regulatory oversight of EC continuing
n/a	Cost of maintaining new branch-lines	Delete as the cost of new single user spurs will not be included in the common system price	Agree with respect to single user spur lines.
<p>The QRC also proposes to add an additional annual SAR adjustment to remove the need for the QCA to apply a revenue smoothing methodology to the derivation of reference tariffs within the regulatory period.</p>			
n/a	Capital Costs expected to be brought into the RAB in the following year.	n/a	Include in the annual adjustment

The QRC opposes the proposal to recover charges from electricity retailers for environmental compliance through AT2-4 (i.e. from all users of the system rather than from users of the electric infrastructure). Aurizon Network is currently able to recover these costs through the EC tariff component. Aurizon Network’s proposal to recover these adjustments (and presumably the original forecast costs of such environmental initiatives) through AT2-4 is based on Aurizon Network’s assertion that “*these charges are more in the nature of a tax or impost on the CQCN’s operations rather than a charge that is specific to the provision of electricity*” (Volume 2, 10.5.2.2). Some comments:

- If the charge was “*in the nature of a tax or impost on the CQCN’s operations*”, one would expect that the relevant Government agency would have sent the invoice to Aurizon Network, not to an electricity retailer.
- The charge is absolutely “*specific to the provision of electricity*”. If a business consumes no electricity, it will not incur these costs. If it consumes more or less electricity, it will incur more or less of this cost.
- The imposts mentioned by Aurizon Network (Renewable Energy legislation and the 13% Gas Scheme) are schemes which required retailers to notionally source (through the acquisition of certificates) a certain portion of their power from certain types of generators (gas, or renewable) rather than from cheaper sources such as coal. A retailer will not incur this cost if it does not purchase electricity, and it will incur more or less of this cost if it purchases more or less electricity.
- In the unlikely event that a tax which is unrelated to the generation, transmission or distribution of electricity is recovered through electricity retailers, as was previously the case with the Queensland ambulance levy, and if this is material, Aurizon Network should seek to amend the Undertaking at that time.

Aurizon Network’s preference for electric train services, and its desire to incentivise the use of these services, has prejudiced its position in UT4. Proposals to achieve this outcome need to be transparent so that they can be considered by stakeholders and the QCA. Attempts to artificially shift costs through proposals such as the one discussed in this section are not helpful.

The QRC also opposes Aurizon Network’s proposal to recover the difference between actual audit costs and forecast audit costs through the annual adjustment to SAR (UT4, 4.3(b)(v)). Aurizon Network contends that it does not have direct control over the value of audit costs incurred each year, rendering such costs difficult to accurately estimate. The QRC considers audit costs should be incurred by the QCA and only recovered from access holders through the QCA levy.

#### **Approval of revenue adjustment amounts**

UT3 (Sch.F, 3.2.10) allows the QCA to seek comments from stakeholders when considering revenue adjustment amounts. Aurizon Network proposes (UT4, 4.3(k)(ii)) to require the QCA to limit its consultation to “Access Holders and Access Seekers”. Given that access charges are most commonly passed through to customers via haulage agreements, we do not agree with Aurizon Network’s statement (Volume 2, P359) that “*it is not considered necessary, or appropriate, to give parties other than Access Seekers or Holders an opportunity to comment on a submission made by Aurizon Network on Revenue Adjustments Amounts or Increments*”. The QRC’s coal-producing members as the end users of access rights consider that they are an extremely relevant stakeholder in regard to the setting of Aurizon Network’s access charges. More generally, we do not consider that the Undertaking should seek to limit the ability of the QCA to seek whatever input it considers relevant.

#### **Clarifications in relation to calculation of charges**

A number of components of access charges under the Operator Access Agreement (Coal) (Clause 3 of Schedule 4) are calculated by reference to Gross Tonnes. Gross Tonnes are defined as:

- for locomotives, the Maximum Desirable Gross Tonnage for that locomotive
- for wagons:
  - if there is a functioning weighbridge, the weight as per the weighbridge (less the tare of the wagon for net tonnes).
  - Otherwise, the Maximum Desirable Tonnage for the Wagon (less the tare of the wagon for net tonnes).

The use of Maximum Desirable Gross Tonnages, including the use of deemed values where weighbridges are not functioning, may result in a significant positive difference between the revenue which Aurizon Network actually earns, and the revenue which would be expected had actual gross and net tonnages been used.

The QRC proposes changes to Schedule F to ensure that:

- The calculations of Total Actual Revenue (4.3(c)) are based on the Gtk and Ntk for which Aurizon Network was entitled to invoice under the terms of the relevant standard access agreement, rather than on Gtk and Ntk of the reference train.
- That the information submitted by Aurizon Network under Clause 4.3(g) should include a reconciliation of the Total Actual Revenue as submitted, with Aurizon Network's actual revenue earned during the period (which should be subject to audit if requested by QCA).

The QRC also considers that overload charges should be included in the calculation of Total Actual Revenue (4.3(c)).

#### **4.4 Deleted Clause 4.4 of Schedule F: Calculation of increment**

Aurizon Network proposes to extend the circumstances (compared to UT3) in which it can earn an increment. Aurizon Network has failed to prepare a DIM which complies with Clause 2.6 of UT3 and has failed to propose reasonable incentive mechanisms in UT4. The proposed increment is not symmetrical, as it provides upside for Aurizon Network with no risk. Given the failure of Aurizon Network to develop reasonable incentive mechanisms over successive undertakings, it is not appropriate to approve this proposed increment. The proposed increment, including the part of the increment which is consistent with UT3, should be deleted until such time as the issue of an incentive mechanism is dealt with.

#### **4.5 New clause 4.4 of Schedule F: Revenue adjustment**

At the time of the introduction of the revenue cap mechanism under UT2, consideration was given to the question of how the revenue adjustment should be recovered. Deferring the recovery by adjusting Second Year System Allowable Revenue was preferred mainly due to concerns regarding whether an adjustment charge could effectively be recovered under existing access agreements. That issue seems to have been resolved in UT3 and UT4.

Adding a shortfall to Second Year System Allowable Revenue has a number of disadvantages:

- Defers recovery of the adjustment, making the timing of Aurizon Network's cashflows uncertain.

- May pass costs (or benefits) to future access holders who may not have held access rights at the time of the relevant shortfall/surplus.

Advantages of the approach include:

- No need for adjustment charges.
- A shortfall adjustment will impact access holders in future years through access charges for usage and through ToP, while an adjustment charge levied by reference to usage would impact those who used their full TSEs the most (despite contributing to the shortfall the least).

The QRC now prefers the recovery of revenue adjustment amounts through an adjustment charge. QRC would like to explore the feasibility of calculating this adjustment charge based on contracted (rather than actual) TSEs, to ensure that access holders which failed to use TSEs do not receive a disproportionately low share of the cost.

#### **4.6 Clause 4.6 of Schedule F: Amendments to calculation and application of increment**

Clause 4.6 allows Aurizon Network to submit amendments to the calculation of the increment including to “*increase the proportion of the System Allowable Revenue at risk*”, which is zero under UT4. Unless the issue of incentive mechanisms is resolved and reflected in a revised UT4, this clause should be replaced by a commitment from Aurizon Network to submit a draft incentive mechanism based on the requirements of Clause 2.6 of UT3.

## **5 Clause 5 of Schedule F: Reference tariff variations**

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### **5.1 Clause 5.1 of Schedule F: Obligation to submit reference tariff variations**

As currently drafted, the QCA appears to have no power to develop a reference tariff variation if Aurizon Network fails in its obligation under 5.1(a)(ii)(1) to submit a variation where a review event has occurred. QCA should have this power, as it does for endorsed variation events.

### **5.2 Clause 5.2 of Schedule F: Endorsed variation events:**

Aurizon Network has proposed the following in regard to endorsed variation events. The QRC’s views in regard to each proposal are also shown in the table:

<b>Endorses Variation Event</b>	<b>Aurizon Network proposal</b>	<b>QRC view</b>
Change in Law or Relevant Taxes	Retain	Agree
Change in pricing of Distribution or Transmission Entities	Retain	Agree

Change in pricing of Retailers (EC)	Removed	Discussed below
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Aurizon Network proposes to remove EC from the list of endorsed variation events, and publish EC on its website each May. This appears to have two effects:

- Aurizon Network will eliminate a further risk, as the endorsed variation event for EC was previously subject to a 2.5% threshold. Aurizon Network acknowledges that this risk was not significant {at Section 10.7.2.1 of Volume 2 of its Submission}, yet seeks to eliminate it. Aurizon Network’s approach to successive undertakings has been to identify and eliminate risks, whether material or otherwise. Aurizon Network has been extremely successful in this process and this should be reflected in Aurizon Network’s WACC. The QRC accepts this further reduction in Aurizon Network’s risk.
- The ability of the QCA to require Aurizon Network to review EC, and to review and approve a new EC, appears to be lost. The QRC considers that this regulatory oversight must be restored. Major electricity purchasers including mining companies dedicate significant resources to ensuring that their purchases of electricity are achieved at a competitive cost. Aurizon Network’s statement that “*the level of the EC charge is completely beyond its control*” (10.7.2.1 of Volume 2) is concerning.

### 5.3 Clause 5.3 of Schedule F: Review events:

Aurizon Network has proposed the following in regard to review events. The QRC’s views in regard to each proposal are also shown in the table:

Review event	Aurizon Network proposal	QRC view
5.3(a) Maintenance costs exceed allowance by more than 2.5%	Retain	Agree
5.3(b) Maintenance costs increases by more than 2.5% due to customer or access holder request	Amend so that Aurizon Network can claim despite having offsetting savings elsewhere in maintenance costs	Disagree (discussed below)
5.3(c) Tendered work (included where awarded to related party) exceeds expected cost and results in increase of more than 2.5%	New review event	Disagree (discussed below)
5.3(d) Additional user connects to spur on which rebate/discount applies	New review event	Agree

5.3(e) Force Majeure causing costs exceeding \$1m	Retain with amended definitions	Agree subject to comments below
5.3(f) Increase in traffic between Burngrove and Minerva	Retain	Agree in principle but adequately covered by review event 5.4(i)
5.3(g) Acceptance of cost allocation principles	New review event	
5.3(h) Change in forecast tonnes relevant to a Capital Indicator	New review event	
5.3(i) Any other material change	Retain	Agree

Comments:

- 5.3(b): This review event is not required, as Aurizon Network can claim such a cost increase under Clause 5.3(a). If it is retained, it should be returned to its UT3 form. Aurizon Network seeks to amend this clause so that it can claim the increased cost despite having offsetting cost reductions in its maintenance functions. This is not appropriate. A review event such as this should only be used to address a substantial cost increase suffered by Aurizon Network. Also, the clause has lost some clarity regarding whether the 2.5% threshold relates to Aurizon Network’s overall AT3, AT4 or AT5 maintenance cost allowances, or relates to the cost of the relevant activity alone. The threshold should be applied to the overall AT3, AT4 or AT5 maintenance cost allowance.
- 5.3(c). This review event is not required, as Aurizon Network can claim such a cost increase under Clause 5.3(a). Using this proposed clause, Aurizon Network may tender work, perhaps in areas where Aurizon Network’s related entities are the only practical supplier, award such work to the related entity, then claim a review event. The 2.5% threshold will easily be triggered as (unlike the other 2.5% thresholds) it relates only to the cost of the work tendered, rather than to Aurizon Network’s overall maintenance costs. The QRC would support a review event such as this only where the QCA, or customers (through a consultation and voting process) have previously approved both the decision to tender the work and the decision to award the work to the preferred party.
- 5.3(e). The QRC accepts this review event but suggests:
  - The definition of “Incremental Costs” is not suitable for use in this clause. For example, “Incremental Costs” include costs brought forward in time. If costs are brought forward in time from a time which is within the term of UT4, we do not consider that this is an incremental cost.
  - The reference to paragraph (e) of the definition of “Force Majeure (Acts of God)” is unnecessary given the extended coverage of paragraph (l) and (m). Paragraph (e) of the definition of “Force

Majeure” should be deleted and to the extent that it was intended to cover any specific events, those should be added.

- The QRC’s members do not again want to accept the risk of losses over \$1m (which we note does not escalate through successive undertakings), while paying insurance premiums through tariffs and having no transparency regarding what risks are covered by those insurance policies. This issue is discussed further in our submission on the pricing principles.

#### **5.4 Clauses 5.4 – 5.5 of Schedule F: Variation event processes**

Clause 5.5(c) should be amended to make it clear that the matters listed in clause 5.5(c) are not an exhaustive list of matters.

### **6 Clause 6 of Schedule F: Variation event processes**

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No comments.

### **7 Clauses 7 – 11 of Schedule F: System specific information**

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The QRC does not support Aurizon Network’s proposal regarding diesel trains in the Goonyella and Blackwater system. Aurizon Network’s proposal is that diesel trains in these systems (other than those operating from Rolleston or Minerva) will not be considered to be reference train services.

The effect of this is that Aurizon Network may seek a differentiated tariff for these services under Clause 6.2.3 of UT4. Aurizon Network’s various submissions on the Blackwater electric traction issue have included numerous assertions regarding unfavourable capacity and other impacts of diesel services. By excluding these services from the reference train specifications, Aurizon Network may seek to reflect these claimed impacts in a differentiated tariff. access holders and access seekers will then be forced to accept, or to individually dispute, this assessment.

The issue of a differentiated tariff for diesel services should be settled as part of the finalisation of UT4 in order to provide certainty for access holders, access seekers, and customers. To the extent that a differentiated tariff is justified on the basis of traction choice, then a diesel reference train service and appropriate reference tariffs should be developed. If those reference tariffs differ from the reference tariffs of electric services based on the criteria set out in Section 6.2.3, then Aurizon Network should explain why such as tariff should not also apply to Rolleston and Minerva.

# Schedule G – Principles for pricing of electric traction services in the Blackwater System

## Overview

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This part of the submission outlines the QRC's position in relation to the proposed principles for pricing of electric traction services in the Blackwater System.

The QRC notes that the proposed Schedule G is the same as the Schedule K proposed as part of the Aurizon Network 2013 AT5 Draft Amending Access Undertaking (DAAU). The QRC notes that the 2013 AT5 DAAU remains under consideration by the Authority.

In summary, the QRC notes that the views of stakeholders on Schedule G and the 2013 AT5 DAAU, and on other Aurizon Network proposals for the pricing of electric traction (in particular Aurizon Network's 2011 Electric Traction DAAU (2011 DAAU) ), have been provided over an extended period and those views have not changed.

Accordingly, the QRC makes no further comment on the proposed Schedule G and instead refers the Authority to the various submissions made by the QRC and its members individually on this matter.

# Standard User Funding Agreement

## Standard User Funding Agreement

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UT4 includes the SUFA documents. The version of the SUFA documents submitted by Aurizon Network as a part of UT4 are an earlier version. That is, a version earlier than the re-submission made by 22 July 2013. The QRC assume that the correct version of SUFA to be considered as a part of UT4 is the SUFA set provided on 22 July.

The submission made by the QRC on Part 8 of UT4 includes some SUFA related changes to Part 8 of UT4.

The QRC otherwise incorporates by reference the submission made by it on SUFA on 30 August 2013. The QRC's SUFA submission of 30 August 2013 should be read as a part of this UT4 submission.

# Incentives

## 1 Overview

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This part of the submission outlines the QRC's position in relation to incentive mechanisms under UT4. UT4 limits the incentive mechanism to the "Increment" set out in Schedule F, clauses 4.3 and 4.4.

In summary, the QRC does not support the UT4 Increment and encourages further investigation by Aurizon Network (including through meaningful consultation with industry) and the QCA into the incorporation of an effective incentive regime in UT4.

## 2 UT4 Incentive

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### 2.1 Background

Aurizon Network's approach to successive undertakings has been to identify and eliminate risks. In the QRC's view, Aurizon Network has been extremely successful in this process.

The change in the form of regulation from a price cap to a revenue cap in 2007 was driven primarily by the desire of Aurizon Network to reduce its exposure to volume risk, a change which the QRC considers should be reflected in Aurizon Network's WACC.

The QRC supported the introduction of the revenue cap in 2007, recognising that:

- (a) factors other than the performance of Aurizon Network often drive volume outcomes, including coal market conditions, mine performance, weather conditions, and the performance of above-rail operators and of ports; and
- (b) if faced with significant volume risks under the price cap, Aurizon Network may be:
  - (1) reluctant to invest;
  - (2) incentivised to focus on seeking approval for low volume forecasts which, if approved, would result in higher reference tariffs and a non-symmetrical volume risk (as the forecast would be more likely to be exceeded); and
  - (3) incentivised, when actual volumes are below forecast, to reduce performance in order to reach a review trigger, and may also face a performance disincentive when volumes exceed forecast and approach the review trigger.

The QRC's key concern with the revenue cap form of regulation was that Aurizon Network lacked any meaningful exposure to the effects of its own performance. Accordingly, the QRC sought the inclusion of an incentives regime to sit alongside the revenue cap.

### 2.2 UT3 Incentive

The need for an incentive mechanism was recognised in UT3 with the inclusion of a commitment by Aurizon Network in the undertaking to develop and submit a Draft

Incentive Mechanism (**DIM**) to the QCA. Aurizon Network submitted a DIM to the QCA in May 2012.

Consistent with the majority of DIM submissions provided to the QCA, the QRC did not support the DIM. In the QRC's view, the DIM:

- failed to comply with the requirements of UT3, clause 2.6;
- provided Aurizon Network with significantly more upside than risk; and
- was likely to be ineffective in driving performance improvements.

## 2.3 UT4 Incentive

UT4 proposes an extension of the circumstances in which Aurizon Network can earn an increment. In the QRC's view, the proposed increment provides Aurizon with potential upside and no downside risk. Aurizon Network also proposes to bring AT1 within the revenue cap, eliminating any incentive effect which the variable AT1 previously achieved.

Aurizon Network has stated that it intends to review the UT4 incentive mechanisms once the QCA's draft decision on the UT3 DIM is released. However, the QRC does not consider Aurizon Network's comments on the feasibility of developing an effective incentive mechanism in UT4 to be encouraging. Aurizon Network has suggested that "many of the issues can be addressed through direct commercial negotiation". As expressed previously, the QRC considers the concept of "commercial" negotiations with a monopoly service provider in the absence of effective regulation to be flawed. In the experience of the QRC's members, the negotiation of important matters with Aurizon Network must be supported by an effective dispute resolution processes to be successful. In addition, Aurizon Network continues to cite its vertical integration as a source of performance incentive. The QRC does not consider that reliance on this incentive is appropriate.

The QRC suggests that the requirements for the DIM, as set out in clause 2.6 of UT3, remain valid. These are that:

- the mechanism is appropriate having regard to the matters listed in s138(2) of the Act;
- the mechanism operates in a manner such that the objective is reasonably related to contracted entitlements;
- the positive incentive that Aurizon Network can obtain for outperformance is proportionate to the negative incentive for under performance (that is, in a symmetrical manner); and
- the mechanism would not potentially have the effect of reducing or increasing any System Allowable Revenue by more than 5%.

The QRC does not support Aurizon Network being placed in a position of being able to earn an increment unless this is part of a balanced package of mechanisms which provides appropriate and reciprocal incentives. The QRC objects to the UT4 increment and also considers that the more limited UT3 increment should not be included in UT4.

## 2.4 Further investigation into an appropriate incentive regime

The QRC is in favour of the inclusion of a genuine incentive regime in UT4 which encourages Aurizon Network to meet or exceed its contractual obligations and the needs of access holders and customers. The QRC recognises the complexity involved in developing an effective incentive arrangement and encourages further investigation by Aurizon Network (including meaningful consultation with industry) and the QCA into the formulation of an appropriate framework.

The QRC has not proposed an incentive framework in this submission. However, in general terms, the QRC is supportive of an incentive arrangement which adopts the following DIM principles:

- symmetrical rewards/risks;
- specific, measurable, achievable, relevant and time bound parameters; and
- parameters that are applied on a system basis.

Like Aurizon Network, the QRC intends to further consider its position regarding an appropriate UT4 incentive mechanism once the QCA releases its draft decision in relation to the UT3 DIM.

## Reference table to the QCA's Consultation Paper

### 1 Overview

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The Queensland Resources Council (**QRC**) acknowledges the items raised by the Queensland Competition Authority (**QCA**) in its Consultation Paper of August 2013 on Aurizon Network's 2013 Draft Access Undertaking (**UT4**). The following reference table sets out the items raised by the QCA and includes corresponding references to where those items have been addressed and discussed in QRC's UT4 submission. The reference table is intended as a guide only.

## 2 Reference table

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
1.2 Matters to consider	<ul style="list-style-type: none"> <li>• QRC 'Regulatory Policy submission'</li> </ul>
<b>2</b> <b><i>Tariffs, revenue management and price setting</i></b>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 6 – Pricing Principles;</li> <li>• QRC Mark-up (Section 2) – Part 6 – Pricing Principles;</li> <li>• QRC Mark-up (Section 2) – Schedules E and F;</li> <li>• QRC Submission (Section 1) – Schedules E and F; and</li> <li>• QRC pricing submission (Section 3), including:               <ul style="list-style-type: none"> <li>– WACC submission;</li> <li>– McKenzie &amp; Partington report;</li> <li>– Castalia report;</li> <li>– Operating costs submission;</li> <li>– Maintenance costs submission;</li> <li>– Capital submission;</li> <li>– Depreciation;</li> <li>– Ballast fouling submission.</li> </ul> </li> </ul>
2.1 Tariffs	See references to '2 <i>Tariffs, revenue management and price setting</i> ' above.

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
2.2 Revenue management	See references to '2 Tariffs, revenue management and price setting' above.
2.3 Rules for setting prices	See references to '2 Tariffs, revenue management and price setting' above.
<b>3</b> <b><i>Negotiating access</i></b>	
3.1 Intent and scope of the access undertaking	<ul style="list-style-type: none"> <li>• Part 2 – Intent and Scope of QRC's Submission (Section 1); and</li> <li>• Part 2 – Scope and intent of QRC's Mark-ups (Section 2).</li> </ul>
Electricity supply	<p>See references to '3.1 Intent and scope of the access undertaking' above and, specifically:</p> <ul style="list-style-type: none"> <li>• Section 2 of Part 2 – Intent and Scope of QRC's Submission (Section 1); and</li> <li>• clause 2.4 of Part 2 – Scope and intent of QRC's Mark-ups (Section 2).</li> </ul>
3.2 Managing Negotiations	See references to 'negotiation framework', 'access agreements' and 'private infrastructure' below.
Negotiation Framework	<ul style="list-style-type: none"> <li>• Part 4 – Negotiation framework of QRC's Submission (Section 1); and</li> <li>• Part 4 – Negotiation framework of QRC's Mark-ups (Section 2).</li> </ul>
Access Agreements	<ul style="list-style-type: none"> <li>• Part 5 – Access agreements of QRC's Submission (Section 1); and</li> </ul>

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
	<ul style="list-style-type: none"> <li>Part 5 – Access agreements of QRC's Mark-ups (Section 2).</li> </ul>
Private infrastructure	<ul style="list-style-type: none"> <li>Part 9 – Connecting Infrastructure of QRC's Submission (Section 1); and</li> <li>Part 9 – Connecting Infrastructure of QRC's Mark-ups (Section 2).</li> </ul>
3.3 Standard Agreements	See references to ' <i>access agreements</i> ' and ' <i>private infrastructure</i> ' above.
Standard Access Agreements	The QRC has not prepared mark-ups of the UT4 Standard Access Agreements ( <b>SAAs</b> ). The QRC's position in relation to the UT4 draft Access Holder Access Agreement – Coal (see references to ' <i>access agreements</i> ' above) should apply (as relevant) to the SAAs.
Standard Rail Connection Agreement	The QRC has not prepared mark-ups of the Standard Rail Connection Agreement. However, see comments in Part 9 – Connecting Infrastructure of QRC's Submission (Section 1).
<b>4</b> <b><i>Managing Capacity</i></b>	
4.1 Existing capacity	<ul style="list-style-type: none"> <li>Part 7 – Available capacity allocation and management of QRC's Submission (Section 1); and</li> <li>Part 7 – Available capacity allocation and management of QRC's Mark-ups (Section 2).</li> </ul>
How to obtain capacity	See references to ' <i>4.1 Existing capacity</i> ' above.

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
How to retain capacity	See references to '4.1 Existing capacity' above.
4.2 New capacity and capacity management	<ul style="list-style-type: none"> <li>• Part 7 – Available capacity allocation and management and Part 8 – Network development and Expansions of QRC's Submission (Section 1);</li> <li>• Part 7 – Available capacity allocation and management and Part 8.1 – Network development and Expansions of QRC's Mark-ups (Section 2);</li> <li>• Part 8.2 – Standard Study Funding Agreement of QRC's Mark-ups (Section 2);</li> <li>• Part 8.3 – Tax Rulings of QRC's Mark-ups (Section 2); and</li> <li>• Part 8.4 – Comparison to submission version of QRC's Mark-ups (Section 2).</li> </ul>
4.2.1 Underlying principles	See references to '4.2 New capacity and capacity management' above.
4.2.2 Baseline capacity, expansions and capacity shortfall	See references to '4.2 New capacity and capacity management' above.
4.2.3 Expansion process, funding options and commercial terms	See references to '4.2 New capacity and capacity management' above.
4.2.4 Project acceptance	See references to '4.2 New capacity and capacity management' above.

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
<b>5</b> <b><i>Information Requirements and Management</i></b>	
5.1      Ringfencing	<ul style="list-style-type: none"> <li>• Part 3 – Ring-fencing and Protections against conflicts of QRC's Submission (Section 1); and</li> <li>• Part 3.1 – Ring-fencing and protections against conflicts of QRC's Mark-ups (Section 2).</li> </ul>
Information handling	<p>See references to '<i>5.1 Ringfencing</i>' above and, specifically:</p> <ul style="list-style-type: none"> <li>• sections 2.4, 2.5 and 5 of Part 3 – Ring-fencing and Protections against conflicts of QRC's Submission (Section 1);</li> <li>• section D of Part 3.1 – Ring-fencing and protections against conflicts of QRC's Mark-ups (Section 2);</li> <li>• Part 3.2 – Ultimate Holding Company Deed of QRC's Mark-ups (Section 2); and</li> <li>• Part 3.3 – Template Confidentiality Deed of QRC's Mark-ups (Section 2).</li> </ul>
Non-discriminatory treatment	<p>See references to '<i>5.1 Ringfencing</i>' above and, specifically:</p> <ul style="list-style-type: none"> <li>• sections 2.2 and 2.3 of Part 3 – Ring-fencing and Protections against conflicts of QRC's Submission (Section 1); and</li> <li>• section A of Part 3.1 – Ring-fencing and protections against conflicts of QRC's Mark-ups (Section 2).</li> </ul>
Management of Aurizon Network	<p>See references to '<i>5.1 Ringfencing</i>' above and, specifically:</p> <ul style="list-style-type: none"> <li>• section C of Part 3 – Ring-fencing and Protections against conflicts of QRC's Submission (Section 1);</li> </ul>

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
	<ul style="list-style-type: none"> <li>• section C of Part 3.1 – Ring-fencing and protections against conflicts of QRC's Mark-ups (Section 2); and</li> <li>• clause 3.3 of Part 3.2 – Ultimate Holding Company Deed of QRC's Mark-ups (Section 2).</li> </ul>
Complaints handling	<p>See references to '5.1 Ringfencing' above and, specifically:</p> <ul style="list-style-type: none"> <li>• section E of Part 3 – Ring-fencing and Protections against conflicts of QRC's Submission (Section 1); and</li> <li>• section E of Part 3.1 – Ring-fencing and protections against conflicts of QRC's Mark-ups (Section 2).</li> </ul>
Waiver	<p>See references to '5.1 Ringfencing' and 'complaints handling' above.</p>
5.2 Reporting	<ul style="list-style-type: none"> <li>• Part 10 – Reporting and auditing of QRC's Submission (Section 1); and</li> <li>• Part 10 – Reporting and Auditing of QRC's Mark-ups (Section 2).</li> </ul>
Content and timing of reports	<p>See references to '5.2 Reporting' above and, specifically:</p> <ul style="list-style-type: none"> <li>• Section 2 of Part 10 – Reporting and auditing of QRC's Submission (Section 1); and</li> <li>• clauses 10.1 to 10.5 of Part 10 – Reporting and Auditing of QRC's Mark-ups (Section 2).</li> </ul>
Audit process	<p>See references to '5.2 Reporting' above and, specifically:</p> <ul style="list-style-type: none"> <li>• Section 3 of Part 10 – Reporting and auditing of QRC's Submission (Section 1); and</li> </ul>

QCA Consultation Paper item	Where the item is discussed in the QRC's submission
	<ul style="list-style-type: none"> <li>clauses 10.6 to 10.9 of Part 10 – Reporting and Auditing of QRC's Mark-ups (Section 2).</li> </ul>
5.3 Disputes	<ul style="list-style-type: none"> <li>Part 11 – Dispute resolution of QRC's Submission (Section 1); and</li> <li>Part 11 – Dispute resolution of QRC's Mark-ups (Section 2).</li> </ul>
Scope of dispute resolution	See references to '5.3 Disputes' above.
Dispute resolution process and timelines	See references to '5.3 Disputes' above.

## Glossary of terms

Term	Meaning
<b>Access-related Functions</b>	has the meaning given by the QRC in its Part 3 submission.
<b>Act / QCA Act</b>	<i>Queensland Competition Authority Act 1997 (Qld)</i>
<b>AHL</b>	Aurizon Holdings Limited ACN 146 335 622
<b>ARTC</b>	Australian Rail Track Corporation Ltd
<b>Aurizon</b>	Aurizon Group
<b>Aurizon Corporate</b>	Aurizon Holdings Limited ACN 146 335 622 and Aurizon Group
<b>Aurizon Group</b>	the group of companies for which Aurizon Holdings Limited ACN 146 335 622 is the ultimate holding company.
<b>Aurizon Network</b>	Aurizon Network Pty Ltd ACN 131 181 116
<b>Confidential Information</b>	has the meaning given by the QRC in its Part 3 submission.
<b>Conflict Protections</b>	has the meaning given by the QRC in its Part 3 submission.
<b>CQCN</b>	Central Queensland Coal Network
<b>CRIMP</b>	Coal Rail Infrastructure Master Plan
<b>DIM</b>	Draft Incentive Mechanism
<b>Infrastructure Act 1994</b>	<i>Transport Infrastructure Act 1994 (Qld)</i>

<b>QCA</b>	Queensland Competition Authority
<b>QRC</b>	Queensland Resources Council
<b>RAB</b>	Regulatory Asset Base
<b>SAR</b>	System Allowable Revenue
<b>SUFA</b>	Standard User Funding Agreement
<b>ToP</b>	Take or Pay
<b>TSE</b>	Train Service Entitlement
<b>Undertaking</b>	UT4
<b>UT3</b>	QR Network's 2010 Access Undertaking (1 October 2010)
<b>UT4</b>	Aurizon Network's The 2013 Undertaking (30 April 2013)
<b>WACC</b>	Weighted Average Cost of Capital
<b>WICET</b>	Wiggins Island Coal Export Terminal