



**QRC SUBMISSION**  
**MAIN SUBMISSION**  
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Dr Malcolm Roberts  
Chair  
Queensland Competition Authority  
Level 27, 145 Ann Street  
Brisbane QLD 4000

Email: [malcolm.roberts@qca.org.au](mailto:malcolm.roberts@qca.org.au)

Copy to: Tania Homan  
John Hindmarsh

**Aurizon Network's draft 2014 Undertaking ('2014 DAU')**

Thank-you for the opportunity to provide this submission on Aurizon Network's draft 2014 Undertaking ('2014 DAU').

Please find attached the QRC's submission which includes both the QRC's Main Submission and the QRC's Mark-up.

Aurizon Network and the QRC have had a number of productive engagements since the submission of the 2014 DAU. As a result of those engagements, progress has been achieved on some of the parts of the undertaking (as reflected in the attached submission), but not all parts.

The QRC remains committed to continuing its engagement with Aurizon Network and the QCA in parallel with the QCA's assessment process. We understand that the QCA faces a challenging task given the extent of changes (many of which we acknowledge are improvements) proposed by Aurizon Network in the 2014 DAU as compared to the 2013 DAU.

Thank-you for your consideration of our submission.

Yours sincerely

Michael Roche  
**Chief Executive**

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## Executive summary

This submission is provided by the Queensland Resources Council (**QRC**) on behalf of its members. A number of QRC members have actively participated in the preparation of this submission.

The QRC confirms that this submission may be made public. The QRC is willing to elaborate on any part of this submission.

In preparing the most recent draft of access undertaking 4 (**UT4**) Aurizon Network has had regard to a number of submissions and comments previously made by the QRC and other stakeholders. For this reason, the QRC is generally supportive of most of the changes to UT4 proposed by Aurizon Network.

In the QRC's view, significant change was needed to UT4. This is because the original submission of UT4 by Aurizon Network presented (in the QRC's view) an ambit position. There remain a number of areas where further change is required to UT4. These changes are identified in this submission.

Time did not afford Aurizon Network the opportunity to consult with the QRC before re-submitting UT4. However, after its resubmission of UT4, Aurizon Network and the QRC have had a number of productive engagements. Those productive engagements resulted in the parties largely agreeing to the terms of Part 4. Accordingly, this submission includes a proposed reworked Part 4 which is substantially supported by Aurizon Network.

Aurizon Network and the QRC have engaged in discussions on other parts of the undertaking, including Part 7, the later part of Part 8 and Part 9. Progress has been made on each of those parts (which is reflected in this submission). With more time, further agreement is likely to be reached.

There are parts of UT4 which have not yet been discussed in detail between the QRC and Aurizon Network. This includes Aurizon Network's funding obligation, preapprovals and SUFA. The QRC's submission explains the QRC's position, and in some cases incorporates previous submissions made by the QRC.

There are other parts of UT4 where the QRC and Aurizon Network has a significant difference of opinion. Ring-fencing is one such provision. In the QRC's view, Aurizon Network has publicly stated their wish to develop a whole of coal chain integrated business. Aurizon Network has clearly stated an interest in port investments and has recently invested in a mining company, Aquila Resources. The QRC and its members are very concerned about Aurizon Network's power in coal chain infrastructure. In the QRC's view, the current ringfencing arrangements are wholly inadequate and ineffective.

The table below explains the QRC's submission on a part by part basis. In most cases, the QRC's submission is comprised of a submission and a mark-up.

## Reference table

Reference to the 2014 DAU	How the item is addressed?	Where the item is addressed?
<b>Part 1 – Introduction</b>	<ul style="list-style-type: none"> <li>No comment.</li> </ul>	<ul style="list-style-type: none"> <li>The QRC supports Part 1 of the 2014 DAU.</li> </ul>
<b>Part 2 – Scope of Work</b>	<ul style="list-style-type: none"> <li>Covering submission</li> <li>Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>QRC Submission (Section 1) – Part 2 – Intent and Scope.</li> <li>QRC Mark-up (Section 2) – Part 2 – Intent and Scope.</li> </ul>
<b>Part 3 – Ring-fencing</b> <b>Schedule D – Ultimate Holding Company Deed</b> <b>Schedule I – Confidentiality Agreement</b>	<ul style="list-style-type: none"> <li>Covering submission</li> <li>Redrafted Part 3 (extracted from the QRC's Main Submission on the 2013 DAU (October 2013))</li> <li>Mark-up of Schedule D and Schedule I</li> </ul>	<ul style="list-style-type: none"> <li>QRC Submission (Section 1) – Part 3 – Ring-fencing and protections against conflicts</li> <li>QRC Mark-up (Section 2) – Part 3.1 - Ring-fencing</li> <li>QRC Mark-up (Section 2) – Part 3.2 (Schedule D) – Ultimate holding company deed</li> <li>QRC Mark-up (Section 2) – Part 3.3 (Schedule I) – Confidentiality Deed</li> </ul>
<b>Part 4 – Negotiation framework</b>	<ul style="list-style-type: none"> <li>Covering submission</li> <li>Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>QRC Submission (Section 1) – Part 4 – Negotiation Framework</li> <li>QRC Mark-up (Section 2) – Part 4 – Negotiation Framework <ul style="list-style-type: none"> <li>This mark-up has been substantially agreed with Aurizon Network.</li> </ul> </li> </ul>

Reference to the 2014 DAU	How the item is addressed?	Where the item is addressed?
<b>Part 5 – Access Agreements</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up of Part 5</li> <li>• Mark-up of the SAHAA</li> <li>• Explanatory table and JW Carter Journal of Contract Law article</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 5 – Access Agreements</li> <li>• QRC Mark-up (Section 2) – Part 5.1 – Access Agreements               <ul style="list-style-type: none"> <li>– This mark-up has been partially agreed with Aurizon Network</li> </ul> </li> <li>• QRC Mark-up (Section 2) – Part 5.2 – Standard Access Holder Access Agreement – Coal</li> <li>• Explanatory table – Appendix 1</li> <li>• JW Carter Journal of Contract Law article – Appendix 2</li> </ul>
<b>Part 6 – Pricing Principles</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 6 – Pricing Principles</li> </ul>
<b>Part 7 – Available Capacity allocation and management</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 7 – Available Capacity allocation and management</li> <li>• QRC Mark-up (Section 2) – Part 7 – Available Capacity allocation and management               <ul style="list-style-type: none"> <li>– This mark-up has been partially agreed with Aurizon Network.</li> </ul> </li> </ul>
<b>Part 8 – Network development and Expansions</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 8 – Network development and Expansions</li> <li>• QRC Mark-up (Section 2) – Part 8.1 – Expansions               <ul style="list-style-type: none"> <li>– This mark-up has been substantially agreed with Aurizon Network.</li> </ul> </li> <li>• QRC Mark-up (Section 2) – Part 8.2 – Network development               <ul style="list-style-type: none"> <li>– This mark-up has been partially agreed with Aurizon Network.</li> </ul> </li> </ul>

Reference to the 2014 DAU	How the item is addressed?	Where the item is addressed?
<b>Part 9 – Connecting Private Infrastructure</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 9 – Connecting Private Infrastructure</li> <li>• QRC Mark-up (Section 2) – Part 9 – Connecting Private Infrastructure <ul style="list-style-type: none"> <li>– This mark-up has been partially agreed with Aurizon Network.</li> </ul> </li> </ul>
<b>Part 10 – Reporting</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 10 – Reporting</li> <li>• QRC Mark-up (Section 2) – Part 10 – Reporting</li> </ul>
<b>Part 11 – Dispute Resolution and Decision Making</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 11 – Dispute Resolution and Decision Making</li> <li>• QRC Mark-up (Section 2) – Part 11 – Dispute Resolution and Decision Making</li> </ul>
<b>Part 12 – Definitions</b>		<ul style="list-style-type: none"> <li>• The QRC's has not proposed amendments to the entirety of Part 12. Rather, the QRC has addressed specific key definitions throughout its submissions on Part 2 to Part 11 of the Undertaking.</li> </ul>
<b>Schedule A – Preliminary, Additional and Capacity Information</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Schedule A and B – Preliminary, Additional and Capacity Information and Access Application information requirements</li> <li>• QRC Mark-up (Section 2) – Schedule A – Preliminary, Additional and Capacity Information</li> </ul>
<b>Schedule B – Access Application information requirements</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Schedule A and B – Preliminary, Additional and Capacity Information and Access Application information requirements</li> <li>• QRC Mark-up (Section 2) – Schedule B – Access Application information requirements</li> </ul>

Reference to the 2014 DAU	How the item is addressed?	Where the item is addressed?
<b>Schedule C – Operating Plan Requirements</b>	<ul style="list-style-type: none"> <li>• Mark-up only</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Mark-up (Section 2) – Schedule C – Operating Plan Requirements</li> </ul>
<b>Schedule D – Ultimate Holding Company Deed</b>	<ul style="list-style-type: none"> <li>• Refer to Part 3 covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 3 – Ring-fencing and protections against conflicts</li> <li>• QRC Mark-up (Section 2) – Part 3.1 (Schedule D) – Ultimate holding company deed</li> </ul>
<b>Schedule E – Regulatory Asset Base</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Schedule E – Regulatory Asset Base</li> </ul>
<b>Schedule F – Reference Tariff</b>	<ul style="list-style-type: none"> <li>• Covering submission</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Schedule F – Reference Tariff</li> </ul>
<b>Schedule G – Network Management Principles</b>	<ul style="list-style-type: none"> <li>• Refer to Part 7 covering submission</li> <li>• Mark-up</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 7 – Available Capacity allocation and management</li> <li>• QRC Mark-up (Section 2) – Schedule G – Network Management Principles</li> </ul>
<b>Schedule H – Explanatory diagrams and flowcharts</b>		<ul style="list-style-type: none"> <li>• The QRC does not have a submission on the content of Schedule H except that it should be updated to reflect the amendments proposed throughout the remainder of the Undertaking.</li> </ul>
<b>Schedule I – Confidentiality Agreement</b>	<ul style="list-style-type: none"> <li>• Refer to Part 3 covering submission</li> </ul>	<ul style="list-style-type: none"> <li>• QRC Submission (Section 1) – Part 3 – Ring-fencing and protections against conflicts</li> <li>• QRC Mark-up (Section 2) – Part 3.2 (Schedule I) – Confidentiality Deed</li> </ul>

Reference to the 2014 DAU	How the item is addressed?	Where the item is addressed?
	<ul style="list-style-type: none"> <li>Mark-up</li> </ul>	
<b>Standard Access Agreements</b>	<ul style="list-style-type: none"> <li>Refer to Part 5 covering submission</li> <li>Mark-up of the SAHAA</li> </ul>	<ul style="list-style-type: none"> <li>QRC Submission (Section 1) – Part 5 – Access Agreements</li> <li>QRC Mark-up (Section 2) – Part 5.2 – Standard Access Holder Access Agreement - Coal</li> </ul>

## 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 the 2014 DAU, as captured in Part 2 of the 2014 DAU (**Part 2**).

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

- 1 the broadening of the scope of the 2014 DAU to include, in addition to access rights, other matters addressed in the Undertaking. Restricting the scope of the 2014 DAU 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 the 2014 DAU misrepresents the true scope of the subject matter of the Undertaking.
- 2 the introduction of an absolute obligation for Aurizon Network to supply electric energy to an Access Seeker or Access Holder, as the QRC considers it is not practical for Access Seekers or Access Holders to procure their own electric energy;
- 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 the 2014 DAU;
- 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 Part 2 mark-up document (**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 4 of this Part 2 of the QRC’s submission).

### 2 Scope

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The QRC does not agree with Aurizon Network’s assertion that the obligation for Aurizon Network to inform Access Holders of land ownership is entirely covered in the Standard Access Agreements. The QRC maintains that the Standard Access Agreements are an acknowledgment by the Access Holder of Aurizon Network’s entitlement to notify in relation to identified ‘third party land’ (and thereby suspend or cease Access Rights to that part of the network). This acknowledgment is not a general obligation for Aurizon Network to inform of changes in relation to any land, including land which Aurizon Network may have previously owned.

The QRC considers that under Part 2 of the 2014 DAU, Aurizon Network should be obliged to promptly notify the Access Holder in writing if Aurizon Network is not the owner of the relevant land and does not have an existing legal right to authorise an Access Holder to access that land.

## 3 Electricity supply

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This section clarifies the QRC's position in relation to certain aspects of Aurizon Network's 2014 DAU electricity supply obligations but does not seek to limit the QRC's Mark-up.

### 3.1 Reasonable terms and conditions

As drafted, the obligation for Aurizon Network to provide electricity to access holders in the 2014 DAU is not absolute. The 2014 DAU merely 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 QRC considers that Aurizon Network should be under an absolute obligation to supply electric energy in connection with access to an access seeker or access holder, as it is not practical for access seekers or access holders to procure their own electric energy. The QRC emphasises this does not mean the supply of electric energy becomes part of Access.

### 3.2 Dispute resolution

Under UT3, disputes in relation to the negotiation of the terms and conditions on which Aurizon Network offers to sell or supply electricity (to an access seeker, access holder or operator) could be referred to dispute under that undertaking. There is no such dispute right under the 2014 DAU.

If there is no ability to dispute a wrongful failure by Aurizon Network to agree to sell or supply electricity, 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.

## 4 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.

### 4.1 Meaning of Associated Services

The 2014 DAU should include a definition of Associated Services which identifies ancillary matters in relation to which it is often impracticable to engage anyone other than 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.

#### **4.2 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.

#### **4.3 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 (but are not obliged to) require Associated Services to be performed by Aurizon Network. Aurizon Network may not unreasonably delay performance of the Associated Services.

#### **4.4 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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Ringfencing and other protections against conflicts of interest are fundamental to whether industry can have confidence that there will be protection of information and a level playing field in access to, and provision of, below rail services.

The regime in the 2014 DAU Part 3 still does not give any such confidence. There have been only minor amendments to Part 3 (Ringfencing) of UT4 in Aurizon Network's 2014 DAU from Aurizon Network's now withdrawn 2013 DAU.

Accordingly, the QRC's significant concerns with Part 3 of UT4 (raised in its previous submissions and also in discussions with Aurizon Network) have not been addressed. In particular, there remains a lack of confidence in the proposed arrangements. The arrangements are weak, while remaining complex.

The QRC's view remains that Part 3 is not effective and meaningful and needs to be rewritten.

The QRC considers that the QRC redraft of Part 3 from its Main Submission on the 2013 DAU (10 October 2013) (**QRC Redrafted Part 3**) is an effective regime, addressing the following key principles in meaningful ways (not necessarily in this order):

- conflict protection and non-discrimination;
- separation of arrangements;
- rail infrastructure ownership;
- management separation;
- scope of ring-fence and confidential information;
- complaints handling process; and
- compliance auditing.

The QRC Redrafted Part 3 is to be preferred as a Part 3 for UT4. For ease of reference, the QRC has repeated the QRC Redrafted Part 3 in the separate mark-up document titled "Part 3.1 – Ringfencing".

Given this view, the QRC has not provided comments on the 2014 DAU Part 3 in mark up. However, the QRC has made various comments below on the specific parts of the 2014 DAU Part 3, including where there have been any amendments by Aurizon Network.

In summary, the QRC's views on Part 3 remain almost entirely unchanged from its previous submissions and those comments and the QRC Redrafted Part 3 remain equally relevant to the 2014 DAU Part 3. The comments below are in addition to, and do not override, those previous submissions.

### 1.1 Reasons for industry concerns

The QRC has previously provided reasons why industry is so concerned with the proposed ringfencing provisions in UT4. In summary, these are:

- the central importance of below rail service in each coal chain, including the significant power Aurizon Network exercises in the connection of new unregulated infrastructure;

- lack of confidence that other relevant Aurizon Group activities and interests (eg rail, port and new rail infrastructure) cannot be preferred or benefited under the existing and future ringfencing regimes;
- complexity of existing and future regimes and preference of form over substance;
- continual promotion by Aurizon Group of the integrated nature of its business, including in light of potential port privatisation.

The significance of these concerns and the scope for conflict is brought sharply into focus by the recent acquisition by the Aurizon Group, together with Baosteel Resources, of Aquila Resources, whose interests include a Queensland coal mine.

## 1.2 General provisions

QRC has consistently proposed there should be an expanded and more balanced approach to description of the intention of Part 3 (the Preamble).

Part 3 should go beyond ringfencing and address the numerous other conflicts of interest. Industry is not seeking merely to adjust the drafting of the description of the purpose in the preamble, but to ensure that the regime implemented by Part 3 in its entirety is meaningful and effective.

The amendment to clause 3.1(h) by Aurizon Network in the 2014 DAU reiterates Aurizon Network's overly narrow characterisation of ringfencing. Whereas, the QRC's view is that the required separation is between the below rail services (and associated costs, revenues, decision making and protection and use of information) from any other upstream or downstream business of the Aurizon Group.

## 1.3 Principles of non-discrimination

Aurizon Network's extension of the non-discrimination principles to ports connected to the CQCN and owned or operated by a related party is still too narrow.

The non-discrimination principles should extend to:

- Aurizon Network and any other related party (not only related operators);
- ports in which the Aurizon Group holds any existing or future interest (not only ports owned or operated by the Aurizon Group);
- railways in Queensland (other than the CQCN) in which the Aurizon Group holds any existing or future interest; and
- coal mines in Queensland in which the Aurizon Group holds any existing or future interest.

The QRC remains of the view that there is merit in including a non-exhaustive list of examples of certain types of prohibited behaviour, such as:

- fast tracking capacity investment to the benefit of the related party operator;
- less frequent or inferior maintenance of third party operated spurs; or
- providing more favourable access prices for a mine that also secure its haulage services with a related operator.

## 1.4 Ultimate Holding Company Support Deed

As the person bound by the Undertaking, Aurizon Network must have an obligation to ensure that the Ultimate Holding Company Deed is in place. An obligation to request the ultimate holding company to enter into this deed is not sufficient.

Furthermore, the scope of the Ultimate Holding Company Deed as proposed by Aurizon Network is too narrow. Aurizon Network has included a general obligation on Aurizon Holdings not to take any action that would cause Aurizon Network to breach its Part 3 obligations. However, this is not sufficient and falls well short of the further amendments to the Ultimate Holding Company Deed that the QRC considers are required. These are set out in full in the mark-up document titled “Part 3.2 - Ultimate Holding Company Deed” and include the following requirements on Aurizon Holdings:

- to provide positive assistance (as is currently required under UT3), including in relation to ownership of rail transport infrastructure (see section 1.6 below) and access to land;
- to require Aurizon parties to comply with Part 3;
- to ensure the management requirements of Part 3 are met. In this regard, QRC notes that Aurizon Network has removed any reference to management requirements from the Ultimate Holding Company Deed. This would appear to be contrary to the provisions of clause 3.9(b) of the 2014 DAU.

## 1.5 Access related functions

The QRC’s view is that the definition of “Access Related Functions” in Aurizon Network’s 2014 DAU is still too narrow. It must include:

- all below rail services and matters integral to the provision of those services;
- development of, and reporting under, UT4; and
- protection of Confidential Information,

and other matters as more specifically set out in the QRC Redrafted Part 3 (Section 3.4).

As the QRC has previously submitted, effective separation of arrangements relating to the services from other activities, necessitates the separation of that part of the business from other business activities. Otherwise, narrow arguments in relation to the difference between separation of the “service” as opposed to “business” lead to an inadequate ringfencing regime.

Accordingly, Aurizon Network’s obligations to perform Access-related Functions should extend to the following concepts:

- a prohibition on transferring, delegating or subcontracting any Access-related Function to a related party that has an interest in any port or railway in Queensland (other than CQCN) (not only a related operator) or an associate of such a party. In light of the recent Aquila acquisition, this should also include a related party that has an interest in any coal mine in Queensland or an associate of such;
- can only transfer, delegate or subcontract Access-related Function to other related parties if the Access-related Function is one of the listed approved exceptions (accounting, finance, legal, risk management, company secretarial, technical train services and construction projects); and
- a prohibition on Aurizon Network undertaking any above rail services; operation or marketing of train services; any port services or holding any interest in a port

in Queensland; any coal mining services or holding any interest in a coal mine in Queensland.

## 1.6 Infrastructure ownership

Aurizon Network must remain responsible as the sole access provider for the declared services. It would be unacceptable for there to be multiple access providers within the Aurizon Group for the same declared service. Accordingly, ownership of all relevant rail transport infrastructure must remain with Aurizon Network.

UT4 must provide a clear avenue for access seekers to challenge allocation of ownership.

The QRC considers that there is still potential for ambiguities in the concept of “rail transport infrastructure” arising from the declaration which mean that the line diagrams effectively define the scope of UT4 and therefore it remains critical that:

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

The QRC Redrafted Part 3 contains proposed drafting on these matters (Sections 3.6 and 3.6).

Also, as mentioned above, the QRC considers it appropriate for the Ultimate Holding Company 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 owned by Aurizon Network for so long as Aurizon Network is the sole access provided for the declared services.

## 1.7 Management and personnel

The QRC’s view is that Access-related Functions must only be performed by Aurizon Network’s employees subject to specified exceptions, including in the circumstances where it is permitted to transfer, delegate or subcontract to a related party (see clause 1.5 above).

The QRC considers that Aurizon Network employees who do perform Access-related Functions should be subject to greater restrictions than those specified in the 2014 DAU Part 3. While the QRC agrees that the restriction should not prohibit the employee from undertaking any other work, a requirement only that the employee should work “primarily” for Aurizon Network and not at the direction of a related operator is not considered sufficient.

In the case of secondments, QRC considers that except for limited exceptions (or as approved by the QCA) all secondments between Aurizon Network and related parties should be prohibited.

The QRC’s Redrafted Part 3 (Section 3.8) sets out the QRC’s proposed implementation of these arrangements.

The QRC has previously raised concerns that the independence of Aurizon Network’s board and board members must be ensured.

The effects of cross-directorships between Aurizon Network and related parties can undermine the effectiveness of the ringfencing principles. This also applies to cross directorships with associated port, rail or mining entities (in which the Aurizon Group

holds an interest). There must not be any cross-directorship as their corporate duties to each company may conflict with the principles of regulation.

Aurizon Network’s management must be separated and independent from related entities (and associated port, rail and mining entities).

The independent management of access rights must extend to a prohibition on acting on directions of any port, rail or mining entity in which an Aurizon party has any interest, not only a related operator.

The QRC’s Redraft Part 3 (Section 3.10-3.13) sets out the QRC’s proposed implementation of these arrangements.

## 1.8 Control and protection of information

### (a) Protected Information/Confidential Information definition

The QRC does not agree with the narrowing of the categories of information protected by the Part 3 regime in UT4 to one of only “Protected Information”.

In broad terms, the “Protected Information” definition is linked to whether:

- if disclosed, the information might reasonably be expected to adversely affect the commercial interests of the discloser; or
- is designated by the discloser as protected.

As previously submitted, the QRC considers that this definition is too narrow and, unless rectified may result in behaviour that is unhelpful to negotiations, such as the discloser designating all information disclosed as “protected” or withholding information due to uncertainty of its likely disclosure within the Aurizon Group.

Aurizon Network has made an amendment to the definition of “Protected Information” in the 2014 DAU (clause 3.11). However, it does not address the QRC’s concerns as it is still dependent on whether or not it is likely to “adversely affect the commercial interests” or is designated as protected upon disclosure.

The QRC’s position is that the obligations for protection of information must cover broader categories of information than is contemplated by the “Protected Information” concept comprising:

- Protected Information; and
- communications, documents and information (whatsoever) regarding or relating to Access-related Functions held, obtained or created by Aurizon Network which by their nature are confidential, such as where the disclosure might reasonably be expected to:
  - unfairly differentiate;
  - afford a related operator or associated port, rail or mining entity an opportunity for unfair advantage; or
  - result in non-compliance with the non-discrimination principles.

The QRC’s Redrafted Part 3 describes this as “Confidential Information”, with all of the Part D obligations then applying to Confidential Information, rather than just Protected Information. Alternatively, with appropriate drafting, this could be achieved by appropriate amendment to the Protected Information definition. At present the definition of “Protected Information” does not address the QRC’s issues.

### (b) Confidentiality Agreement

Aurizon Network has included a new provision requiring Aurizon Network to enter into a confidentiality agreement upon request.

The QRC has separately provided comments on the proposed confidentiality agreement by way of mark up. The QRC's mark-up of the confidentiality agreement is set out in the mark-up document titled "Part 3.3 – Confidentiality Deed".

In relation to the obligation in Part 3 (clause 3.14), the QRC's view is that it should not only be available to an "Access Seeker" or "Train Operator" during a "Negotiation Period". A person who wants access or increased access should be entitled to request Aurizon Network to enter into such an arrangement even if an access application has not been lodged, for example during initial enquiries.

**(c) Use and disclosure of Confidential Information**

The QRC's view is that the provisions for access and disclosure of protected information in the 2014 DAU Part 3 are overly complex and confusing, which increases the likelihood of inappropriate disclosure. Even without the level of complexity, there are permitted disclosures which, in the QRC's view, are not appropriate or too broad.

The QRC's view is that the QRC Redrafted Part 3 (Sections 3.18 and 3.19) provide a simpler and more effective regime which is nevertheless appropriate for Aurizon Network's purposes.

**(d) Register**

As previously submitted, the QRC's view is that the register must apply to all "Confidential Information" and must be more comprehensive than proposed in the 2014 DAU. In particular, it must cover all disclosures whether within the Aurizon Group or to third parties.

**(e) Training**

Aurizon Network has included the mandatory training requirement for Aurizon Group employees identified as "high risk".

The QRC is supportive of this. However, it has remaining concerns about the following issues:

- The obligation to provide training for those "receiving or having access to" Confidential Information (Protected Information) is limited to Aurizon Group (including Aurizon Network) employees. This category should also apply to "other persons" (as the potential persons who might have access might include non-employees).
- The QRC remains of the view that a provision providing for a tiered structure for minimum training requirements is required. It is clear that there is a culture of secondment within the Aurizon Group and therefore, it is considered appropriate for all employees to undertake some form of minimum training.

**(f) Security measures**

QRC's view is that the security of Confidential Information should be the focus, not merely physical access to its major office premises. This is reflected in the QRC Redrafted Part 3 (Section 3.23).

## **1.9 Complaints and waiver**

As previously submitted, the QRC's view is that:

- the complaint regime in UT4 should be expanded to ensure stakeholders have a non-litigious avenue for recourse where there is a breach of the Ultimate Holding Company Deed or a confidentiality agreement; and

## **1.10 Auditing, reporting and dispute resolution**

The QRC's view is that auditing and reporting of compliance with the Part 3 obligations, including compliance with the Ultimate Holding Company Deed, are essential to effectiveness of the regime and industry confidence in the regime. The QRC considers these must be provided for in Part 10.

The QRC also considers that the Part 11 dispute resolution mechanisms must be available for Part 3 disputes.

## **1.11 Extension of Part 3 to persons before submission of an access application**

Part 3 matters, including the non-discrimination principles and the protection and control of information are important to a person who wants access, or increased access, whether or not an access application has been lodged.

A person may not be confident to make or progress initial enquiries if Aurizon Network's non-discrimination obligations and confidentiality obligations under Part 3 do not apply to it unless and until an access application has been lodged.

Therefore, references in Part 3 to an "Access Seeker" must extend to those persons whether or not an access application has been lodged, including, as mentioned above in section 1.8(b), the obligation of Aurizon Network to enter into a confidentiality agreement with the person if requested.

## Part 4 – Negotiation framework

### 1 Improvements included in Aurizon Network's 2014 DAU

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Aurizon Network's 2014 DAU included a substantial number of improvements which reflected feedback of the QRC and other stakeholders on the 2013 DAU. These improvements included:

- **Clause 4.3(c):** a mandatory requirement for Aurizon Network to notify an Access Seeker if its application is incomplete, and to inform the Access Seeker of what information is required in order for the application to be complete;
- **Clause 4.3(d) and (f):** clearer definition of the type of information which Aurizon Network may require when considering an Access Application;
- **Clause 4.3(e):** amendments allowing access applications to be made up to 5 years before access rights are to commence in some circumstances;
- **Clause 4.6(v) and (vii):** requirement for an indicative access proposal (**IAP**) to provide detail on the estimated access charge according to the pricing principles and to contain information on expansion planning;
- **Clause 4.10.1(d):** reinstatement of the UT3 mechanism for proceeding with negotiations in regard to some or all of the Access Rights sought where Aurizon Network becomes unable to offer access because of a reduction in available capacity or infrastructure enhancements;
- **Clause 4.12(c):** Aurizon Network given the ability (but not required) to cease negotiations with an operator which is not acting on behalf of a specified customer on the basis that such an Access Seeker has no genuine intention of obtaining Access Rights or has no reasonable likelihood of utilising Access at the level sought;
- **Various clauses:** a number of tests under Part 4 have been amended to provide for an objective standard rather than a subjective standard; and
- **Various clauses:** obligations have been placed on Aurizon Network to act reasonably and in good faith in carrying out certain steps.

### 2 Further improvement sought

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The QRC welcomes the changes included by Aurizon Network in Part 4 of the 2014 DAU and appreciates Aurizon Network's efforts to respond to feedback. However, the QRC seeks further improvements to Part 4, primarily to:

- revise the drafting of some of the matters listed above, so that the changes fully address the issues of concern to QRC;
- address a range of other matters on which the QRC provided feedback previously, which have not been addressed in the 2014 DAU; and
- take the opportunity to further improve and update Part 4 given that a substantial period of time has passed since feedback was provided on the 2013 DAU.

The QRC’s proposed amendments to Part 4 of the 2014 DAU are set out in the separate mark-up document labelled “Part 4 – Negotiation Framework” (**Mark-up**). This section of the QRC’s submission clarifies the QRC’s position in relation to certain key aspects of Part 4 but does not seek to limit the QRC’s Mark-up. Capitalised terms in this submission have the same meaning as in the 2014 DAU unless otherwise indicated.

The changes proposed in the Mark-up have been discussed and developed in consultation with Aurizon Network. It is the QRC’s understanding that the changes sought are supported by, or acceptable to, Aurizon Network with the exception of clauses 4.4(c)(i)-(ii) and 4.12(d)(iii).

The key changes included in the Mark-up are described below.

- **Clause 4.3(f)**: new provision requiring that Aurizon Network give a notice which terminates a request for Access if the Access sought relates to a transfer and the Access Seeker has not provided evidence (as required under Schedule B) that the Customer of the Transferor consents to the transfer.

This is intended to prevent Aurizon Network from waiving this requirement. This is important as, if the requirement was waived, a Customer / mine could find that Access Rights relating to its origin / destination have been transferred to another origin / destination without its knowledge or consent.

- **Clause 4.3(g)**: revised drafting ensures that an Access Application will not be terminated due to insufficient information being provided by the Access Seeker where the failure to provide the information meets certain requirements (the “Non-Availability Requirements”).

This is intended to ensure that the unavailability of certain information does not prejudice the progress of an Access Application, provided there is a reasonable explanation for the unavailability, and provided that the unavailability does not indicate that the Access Seeker is unlikely to be able to use the Access Rights sought. For example, where an Access Application relates to Access Rights required three years in the future, the lack of a signed above-rail contract may be considered reasonable, and may not indicate a likely inability to use the Access Rights sought. Similar changes, which ensure that information which is required to be provided is appropriate for the stage of development of projects, are proposed in clauses 4.4 and 4.10.

- **Clause 4.3(h)**: revised drafting (and a similar amendment to clause 4.12) ensures that an Access Seeker who intends to transport coal for another party (i.e. an operator transporting for a Customer) cannot progress an Access Application unless the intended Customer confirms (and maintains) its support of the application. The QRC considers that this is important because:
  - if the proposed Customer is not willing to indicate support for the application (despite this involving no cost or commitment on the part of the Customer), then it is reasonable to conclude that the Access Seeker is unlikely to use the Access Rights at the level sought. For example, the Access Seeker will be unable to demonstrate:
    - that it has Supply Chain Rights (clause 4.12(c)(ii)(A)), particularly any right to use a loading facility; and / or
    - that the anticipated output of the mine is sufficient to support the utilisation of the Access Rights (clause 4.12(c)(ii)(D)); and
  - if Operators are permitted to secure Access Rights for no particular Customer, then monopoly power could effectively be transferred from Aurizon Network, whose monopoly power is limited by regulation, to an Operator. For example, if Operator ‘x’ secures all of the capacity in

the next major expansion within a coal system, then that party can control the allocation and pricing of that capacity, largely free of the constraints of the undertaking. Capacity resumption provisions do not provide a solution to this issue, as it is highly likely that the operator will secure customers, possibly on onerous terms, so that the Access Rights are then used.

- **Clause 4.4:** references to Customer Specific Branch Lines (CSBLs) have been removed in this section. It is the QRC's understanding that new CSBLs that occur during the term of UT4 will not be included in the RAB. This means that all CSBLs (arising during the term of UT4) will be private infrastructure and as a result it is not appropriate that a negotiation process be suspended due to a CSBL being required in the same way as negotiations are suspended when an Expansion is required. Financing, design and construction of the CSBL is a matter to be resolved by the Access Seeker or its Customer, in the same way as construction of, or access to, loading and unloading facilities needs to be resolved. An Access Seeker ought to be able to progress its application as long as it has a credible plan for providing the CSBL, and is making progress appropriate to its stage of development and taking into account the date from which Access Rights are sought. Further amendments to Parts 4.3, 4.10 and 4.12 have been suggested to achieve this approach.
- **Clause 4.4(c)(i), (ii):** where an Access Application is for Access Rights which cannot be provided in the absence of an Expansion, the Access Seeker should have the option to progress the Access Application, in the absence of an Expansion, for that part of the Access Rights that can be provided. The drafting proposed by the QRC seeks to provide this flexibility and mirrors a similar right which already exists under clause 4.10.1(d) after the issue of an IAP.
- **Clause 4.4(c)(v):** the drafting in clause 4.4(c)(v) is confusing and uncertain. Where Access Rights cannot be accommodated without an Expansion, the suspension of negotiations should be lifted once Planned Capacity exists which is capable of being allocated to the Access Seeker.
- **Clause 4.4(c)(vi):** the suggested additional drafting requires that Aurizon Network does not discriminate when applying Part 4 on the basis of financing arrangements. For example, Aurizon Network should not discriminate against an Access Seeker who is using SUFA. This concept is provided in Part 8 but must also be repeated in Part 4 to prevent discrimination in the performance of the Part 4 processes.
- **Clause 4.5:** this has been amended so that, when an Access Application is deemed to have been withdrawn due to the Access Seeker requiring a Material Variation, a new application (as amended by the variation) is immediately deemed to have been submitted. This is suggested as an efficient mechanism for commencing the process for the revised Access Application.
- **Clause 4.6:** the proposed change ensures that Aurizon Network must always include an Initial Capacity Assessment in the IAP. This is important information for the Access Seeker.
- **Clause 4.8:** the key change in this section is to ensure that, where two operators seek the same Access Rights for the same Customer, Aurizon Network will negotiate with each Operator until the Customer selects its preferred operator. This assists Customers while a tender / negotiation process is underway with Operators, and therefore promotes above rail competition. The deletions in this section are largely a move of drafting to a new clause 4.9.
- **Clause 4.10.3:** the revised drafting reflects a significant shift in the approach to Material Variations requested by an Access Seeker after the preparation of the

IAP. Under Aurizon Network’s 2014 DAU drafting, if an Access Seeker sought to make a Material Variation, the access application was deemed to be withdrawn, and a new application including the variation was deemed to be submitted. This is acceptable in the IAP preparation stage, as the time lost by returning to the beginning of the application process is unlikely to be significant. However, this approach is not suitable in the negotiation phase, because beginning a new process which is subject to the standard timeframes under the undertaking could cause substantial delays. The QRC’s concern is that a Material Variation could occur some months into the application process, and a significant period of time could be lost by restarting the application process. In some cases, QRC considers that a change which meets the definition of Material Variation will in fact be relatively minor, such that Aurizon Network can revise the IAP and continue negotiations within a relatively short period. Rather than debating the definition of Material Variation so that only changes which are ‘very material’ cause the process to restart, QRC suggests that a Material Variation should not cause an Access Application to be deemed to be withdrawn. Instead, it is proposed that Aurizon Network should be allowed a reasonable period to revise the IAP, and that timeframes within the negotiation process should be extended for this reasonable period. The revised drafting reflects this approach.

- **Clause 4.12(d)(iii):** this clause, proposed by Aurizon Network, seeks to deem Aurizon Network to have complied with the 2014 DAU, and to exclude liability, for wrongfully issuing a Negotiation Cessation Notice, provided that Aurizon Network has made a ‘good faith and reasonable attempt’ to comply with clause 4.12. The QRC proposes deletion of this clause. Aurizon Network should not be relieved of a breach of the 2014 DAU simply because in its failure to comply with the 2014 DAU it was using good faith. Aurizon Network has adopted clause 4.2(d)(iii) from the DBCT access undertaking. The QRC notes that the DBCT access undertaking was submitted to the QCA by DBCT Management and the DBCT users as an agreed package (including pricing related matters). The same cannot be said of the Aurizon Network 2014 DAU.

## Part 5 – Access agreements

### 1 Overview

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This part of the submission outlines the QRC's position in relation to Part 5 of the 2014 DAU and the draft Access Holder Access Agreement - Coal (**AHAA**).

The QRC has proposed some minor amendments to Part 5 of the 2014 DAU which are reflected in the separate mark-up document labelled "Part 5.1 – Access Agreements" (**Part 5 Mark-up**). The majority of the amendments proposed in the Part 5 Mark-up have been agreed with Aurizon Network. To the extent the QRC has proposed additional amendments which have not been agreed with Aurizon Network, those amendments are discussed in section 2 of this Part 5 submission.

The QRC has also proposed significant amendments to the 2014 AHAA which are incorporated in the Access Agreement Mark-up (**AHAA Mark-up**). Many of these amendments were also incorporated in the QRC's mark-up of the 2013 DAU draft Access Holder Access Agreement - Coal and remain points of difference between the QRC and Aurizon Network.

The QRC has prepared an explanatory table (refer to Appendix 1) outlining the reasoning for the QRC's response to a number of the AHAA key issues. This explanatory table does not seek to limit the QRC's AHAA Mark-up.

The AHAA Mark-up should apply (as relevant) to all Standard Access Agreements. To avoid duplication, the QRC has not prepared mark-ups of the other 2014 DAU Standard Access Agreements. However, if the QCA would find mark-ups of the other 2014 DAU Standard Access Agreements helpful, the QRC is happy to provide these documents as part of a supplementary submission.

### 2 Part 5 Mark-up

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The QRC's proposed Part 5 Mark-up seeks to clarify that a renewing access seeker should not be treated any differently from any other access seeker in respect of its ability to adopt the standard access agreement. The standard access agreements under UT4 should apply to any access application including where that access application relates to a renewal.

The QRC also proposes to allow access holder with a right to request to move over to the most current generation of standard access agreement at any time. The QRC understands that this is a practice which has historically been adopted by Aurizon Network, however, has not been previously reflected in UT3. The QRC proposes to embed this practice into UT4. The QRC has not yet provided drafting to address this proposal however is willing to work with both the QCA and Aurizon Network to develop this idea further.

### 3 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 AHAA Mark-up. Capitalised terms in this submission have the same meaning as in the AHAA unless otherwise indicated.

## 3.1 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.

The QRC maintains the view that 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. The current arbitrary trigger proposed by Aurizon Network is also inappropriate in circumstances where an End User with an existing operation or proposed new operation does not have a credit rating, but is otherwise financially capable (for example a private company). In such circumstances, the current drafting of the AHAA would require the End User to provide Security to Aurizon Network even though this would be unnecessary if Aurizon Network were to consider the financial capability of the End User as a whole.

### Security Amount

The QRC 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. Further, the QRC considers that the Security Amount should be an amount equivalent to half of the maximum TOP Charges for all Train Service Types that could potentially be payable during the applicable year, subject to the assumptions in the AHAA, rather than one year as proposed by Aurizon Network. In the QRC's view, Aurizon Network's increase of the Security Amount to the maximum amount of the TOP Charges for all Train Service Types that could potentially be payable during the applicable year cannot be justified considering the Security Amount was previously a 3 month proportion of these charges.

## 3.2 Operation of Train Services

### Supply Chain Rights

In the QRC's view, the Supply Chain Rights provisions in the AHAA remain overly prescriptive and onerous. While the QRC appreciates the efforts of Aurizon Network to respond to the QRC's feedback regarding Supply Chain Rights, the QRC seeks further improvement to this section of the AHAA.

The QRC maintains that 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 and is of the view that Aurizon Network's amendments to the AHAA do not sufficiently address the concerns of industry.

The QRC maintains that the End User should be obliged only to show that it holds or has a reasonable likelihood of obtaining Supply Chain Rights. To ensure End User accountability, the QRC's AHAA 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

The QRC considers a number of aspects of the AHAA, including the new Access Interface Deed, to not represent a fair commercial risk allocation. In particular, the QRC

objects to Aurizon Network attempting to broadly exclude all liability of Aurizon Network to the Operator.

The purpose of the Access Interface Deed should be to contractually bind the Operator to the same limits of liability that exist in the Access Agreement. That can be achieved by a simple statement referring to the limitations of liability in the Access Agreement, as well as an acknowledgement of the aggregate nature of financial liability. As is noted above, Aurizon Network’s drafting goes far beyond this in an attempt to prevent itself from incurring any liability whatsoever to an Operator.

### **3.3 Dealing with Access Rights**

#### **Resumption of Access Rights**

The QRC considers that the resumption provisions of the AHAA continue to operate unreasonably harshly in spite of amendments made by Aurizon Network. The QRC’s AHAA Mark-up has again sought to provide a more balanced approach by:

- narrowing the scope of an “Underutilisation Event”;
- specifying particular 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 QRC maintains that the time to determine whether a Capacity Shortfall exists must be no longer than 6 months. The QRC also maintains changes to the Capacity Shortfall provisions are required so that Conditional Access Rights in respect of an Expansion cannot be reduced where the Capacity Shortfall is caused by an act or omission of Aurizon Network.

The QRC has also amended the requirements of Capacity Assessment Notices to require Aurizon Network to outline the reason(s) for the Capacity Shortfall and to provide that disputes should be able to be raised in relation to the reason(s) for the Capacity Shortfall.

#### **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 maintains Aurizon Network should be obliged 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. The QRC has also clarified that the End User may dispute any component of the Relinquishment Fee.

#### **Transfers**

The QRC and Aurizon Network are separately negotiating with respect to Transfers and the QRC relies on its submission in respect of Part 7 to the extent that submission is relevant to the AHAA. It is the QRC’s view that the substantive transfer provisions should be provided for in the 2014 DAU rather than the AHAA.

### **3.4 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 maintains it is reasonable for this obligation to be limited to the extent that the terms and conditions have been notified to the End User. The QRC again notes this is consistent with the approach adopted in UT4 in respect of environmental authorities.

### **3.5 Discretionary System Amendments and System Wide Requirements**

The QRC considers that Aurizon Network should be required to notify the End User of any Discretionary System Amendment irrespective of whether it will fundamentally frustrate the Operator's operations of Train Services over a sustained period. 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.

### **3.6 Interface Representative**

The QRC considers the requirement for an interface representative should be mutual. Accordingly, the QRC has incorporated a reciprocal right for the End User to, acting reasonably, cause Aurizon Network to nominate a different representative of Aurizon Network where the End User is not satisfied with the performance of an Aurizon Network Interface Representative.

### **3.7 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 remains unreasonably broad. The QRC's AHAA Mark-up subjects this indemnity to the limits of liability set out in clause 33 of the AHAA.

### **3.8 Limitations and exclusions of liability**

#### **Consequential Loss**

The definition of "Consequential Loss" in the AHAA lacks certainty. The QRC again emphasises there is no settled meaning at law of "special", "indirect", "consequential" or "economic" loss. Numerous Courts have confirmed that those words are not settled legal terms of art. The QRC cannot accept Aurizon Network's position in respect of the definition of "Consequential Loss" and notes that no progress has been made during negotiations on this point.

#### **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 maintains that this exclusion of liability is 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 Aurizon Network breaches the agreement or is negligent.

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

The QRC has again 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 own act or omission 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 AHAA Mark-up, the QRC has removed the carve out for delays attributable to other Railway Operators to align the Parties' obligation to use best endeavours to reschedule a Train Service which is unable to be

operated. The QRC acknowledges the removal by Aurizon Network of the carve out for delays attributable to customers of other Railway Operators.

### **3.9 Material Change**

The QRC considers the definition of “Material Change” remains unreasonably broad despite minor amendments by Aurizon Network. The QRC has sought to limit the scope of this definition by narrowing the definitions of “Relevant Taxes” and “Change in Law”.

### **3.10 Suspension**

The QRC does not agree with the amendments made by Aurizon Network to suspension events in Part B of Schedule 9. The QRC’s AHAA Mark-up proposes minor amendments to the suspension events in Part B of Schedule 9 for clarification and ensure the suspension events listed are reasonable and commercially sound.

### **3.11 Termination**

The QRC’s AHAA 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. The QRC maintains flexibility is required to account for any delay End Users may encounter in the removal of rollingstock.

As with the suspension, the QRC does not agree with the amendments made by Aurizon Network to termination events in Schedule 9 and has proposed mark-up accordingly for clarification and to ensure the termination events listed are reasonable and commercially sound.

### **3.12 Take or pay and definition of “Aurizon Network Cause”**

The definition of “Aurizon Network Cause” is too wide for the purposes of TOP clauses under the AHAA. This issue is discussed in further detail in the part of this submission titled “Schedule F – Reference Tariff” (see Section 2). The QRC’s comments made in that section of this submission apply equally to the AHAA.

## Part 6 – Pricing principles

### 1 Comments on changes in 2014 DAU

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This section clarifies the QRC’s position in relation to certain key aspects of Part 6 of the 2014 DAU (**Part 6**). Capitalised terms in this submission have the same meaning as in the 2014 DAU unless otherwise indicated.

Aurizon Network’s 2014 DAU includes substantial changes to Part 6 as compared to the 2013 DAU. The changes are predominantly in response to the QRC’s October 2013 submission, and largely adopt the QRC’s suggestions. The QRC appreciates Aurizon Network’s efforts to respond to customer preferences in this area of the 2014 DAU, and consider that the current draft of Part 6 is a substantial improvement on the 2013 DAU and on UT3.

A number of the QRC’s members have indicated they require more time to review the changes and to understand this complex area of the 2014 DAU. The QRC proposes that a workshop be held, so that Aurizon Network can explain the intention of the drafting, and stakeholders can raise questions. It is suggested the QCA also attend this session. The QRC’s members would then be in a position to provide final views on Part 6 either ahead of, or in response to, the QCA’s draft decision.

A number of issues have arisen from the QRC’s review of Part 6 to date. The QRC has not provided revised drafting at this stage, as the QRC does not yet have a firm view on the appropriate solution to each issue. A summary of the QRC’s current position on Part 6 is set out below.

Clause	Comment
6.2.4(a)	This clause provides that System Reference Tariffs (and not an Expansion Tariff) will always apply in cases where Aurizon Network chooses to fund an Expansion under Clause 8.2.1(b). This would limit the application of the remainder of Part 6.2.4 to user funded projects. Our understanding of the intent of this drafting is that Aurizon Network does not wish to be obliged, under the 2014 DAU, to fund any project which will be subject to an Expansion Tariff, on the basis that such a project may have higher asset stranding risk. The QRC is willing to discuss this issue in the context of a mandatory funding obligation which Aurizon may have under the undertaking. However, the QRC does not consider it appropriate to deal with the issue by allowing the pricing principles to be bypassed, as these principles provide important protections for existing Access Holders and their customers.
6.2.4(i)(ii)(E)	This section requires that the analysis undertaken to determine whether an Expansion Tariff should apply, or an existing Reference Tariff should be varied, should be undertaken at the end of each quarter, until the peak point for contracted Access of the expansion is reached. The QRC’s understanding of the intent of this provision (which we do not consider is clear from the drafting) is that this would be a series of discrete quarterly ‘socialisation’ tests, such that an Expansion Tariff would be created if the test indicated that this was required for the first quarter, and so on until the Expansion Tariff was no longer required. The QRC would like to discuss an assessment period that is applied over a longer timeframe, such that if a socialised tariff would make existing users ‘no worse off’ when viewed over a period of ‘x’ years (or perhaps for the term of an

Clause	Comment
	undertaking), the creation of an Expansion Tariff could be avoided on the basis of this longer term test, notwithstanding that this may raise the existing Reference Tariff initially.
6.2.4(n)	We are concerned that the deferral allowed under this clause will leave customers in a position of lacking information which is critical for planning and decision making.
6.2.5(c)	We do not understand the relevance of Customer Specific Branch Lines ( <b>CSBLs</b> ) in this analysis. Our understanding is the CSBLs will not form part of the RAB and will therefore not cause any increase in Allowable Revenue.

## Part 7 – Available capacity allocation and management

### 1 Improvements included in Aurizon Network's 2014 DAU

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Aurizon Network's 2014 DAU included a number of improvements which reflected feedback of QRC and other stakeholders on the 2013 DAU. These included:

- **Clause 7.1(e):** Clarification that allocation of capacity is independent of funding arrangements.
- **Clause 7.3(b):** Amendments to provide some flexibility in regard to origin/destination when renewing access rights.
- **Clause 7.3(g):** Clarifies that, in processing a renewal application, Aurizon Network must follow the usual processes of Parts 4 and 5 of the Undertaking (and therefore that Aurizon Network does ultimately have an obligation to enter into the renewal access agreement, subject to those provisions).
- **Clause 7.5.2(c)(ii)(E):** Ensuring that a renewal access application will not be disadvantaged because it is for a term of less than 10 years, provided that the term sought is equal to the remaining mine life.
- **Clause 7.6.3:** Amended so that Aurizon Network will be required to develop System Rules if requested by Access Holders who hold a certain percentage of Access Rights.

### 2 Further improvement sought

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The QRC welcomes the changes included by Aurizon Network in Part 7 of the 2014 DAU. However, the QRC seeks further improvements to Part 7.

A mark-up of Part 7 against the 2014 DAU version 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**). The changes proposed in this mark-up have been discussed, and developed in consultation with, Aurizon Network. The QRC has sought to indicate, in the mark-up, our understanding of the extent to which Aurizon Network supports the proposed changes.

The key proposed changes, and reasons for the changes, are explained below. This is not an exhaustive list of the changes proposed in the mark-up. To the extent that the reason for any of the changes is not discussed below or is unclear to the QCA, the QRC would be pleased to provide further explanation.

Key changes to the 2014 DAU proposed by the QRC are as follows:

- **Clause 7.1(e):** In light of the fact that customers may fund studies or expansions, this paragraph should refer to customers as well as access seekers.
- **Clause 7.2:** This paragraph has been amended to reflect the equivalent language used in clause 4.12(b)(ii) of the QRC's Part 4 mark-up. Wherever relevant, consistent language should be used so as to avoid a suggestion that a different intent was intended.
- **Clause 7.3(a):** This paragraph has been amended to clarify the intent of this clause – that is, that the renewal right attaches to the access rights immediately

before expiry and not different access rights earlier in time. Without this change there could be a suggestion that the renewal must apply for the same tonnage profile.

- **Clause 7.3(c):** This paragraph has been amended to acknowledge that the renewing access seeker may apply for a lesser quantity of access rights.
- **Clause 7.3(d):** The 2014 DAU provides that a renewing access seeker should execute a renewed access agreement no later than 12 months before the expiry of the expiring access agreement. The paragraph has been amended to acknowledge that this requirement does not apply where the failure to enter into an access agreement is attributable to Aurizon Network.
- **Clause 7.3(g):** This paragraph has been amended to acknowledge that a renewal does not require Aurizon Network to enter into the same access agreement terms. The QRC have proposed an additional sentence which is not supported by Aurizon Network to the effect that Aurizon Network is obliged to enter into an agreement on the Standard Access Agreement terms (to the extent that the other relevant provisions of Part 4 are satisfied).
- **Clause 7.3(h):** Clause 7.3(h) has been amended to note that, except as provided in clause 7.3(h), the negotiation cessation and availability provisions of clause 4 do not apply to a renewing access application. Without this amendment, the priority arrangements for renewals will not be effective.
- **Clause 7.4:** A more efficient transfer mechanism is required. Transfers and short term transfers in particular are likely to be more common in the current market for coal. Aurizon Network have prepared a proposal in relation to short term transfers. The QRC's comments are set out in the latter part of this Part 7 submission.
- **Clause 7.4.2:** The QRC proposes to restrict the application of the mutually exclusive access application provisions so that those provisions only apply to transfers to the extent of any ancillary access rights. The transfer should in all other circumstances be afforded priority.
- **Clause 7.5.2(d)(iii):** The QRC has proposed the deletion of this paragraph. This deletion is not supported by Aurizon Network. In the QRC's view, the paragraph is unnecessary because of the revenue cap.
- **Clause 7.5.2(d)(vi):** The QRC has proposed deleting this paragraph. The deletion is not supported by Aurizon Network. In the QRC's view, the paragraph is both uncertain and unnecessary in light of clause 7.5(c)(ii)(E) above.
- **Clause 7.5.2(d)(vi)(B):** Both the QRC and Aurizon Network agree that this paragraph should be deleted. In retrospect, it should not be the access provider's role to consider the marketability of coal.
- **Clause 7.5.2(g)(iv):** This paragraph has been amended to deal with material variations to access applications. In particular, the date of a varied access application, should be dependent on the date on which the access seeker notifies Aurizon Network that it wishes to progress with the varied access application.
- **Clause 7.6:** The QRC has proposed significant changes to this section. The changes are to substantially simplify the section. The QRC consider that the key provisions of the section should be to oblige Aurizon Network to always have system rules for a coal system. The system rules should be reviewed each year and Aurizon Network should notify the QCA of the proposed amendments or if it does not consider amendments are warranted, the reasons for that. The QCA should seek public comment and make a determination on the system rules

which the QCA must comply with. Aurizon Network have not reviewed the QRC's proposed changes on this section.

### 3 Short term transfer mechanism

The QRC has engaged in consultation with Aurizon Network regarding a new mechanism for short term transfers. We understand that Aurizon Network intends to provide the QCA with a discussion paper setting out its proposed approach to short term transfers. In this section, we describe our understanding of the short term transfer arrangement which Aurizon Network intends to propose (that is, our understanding of the proposal based on our most recent discussions with Aurizon Network) and comment on the extent to which we consider that Aurizon Network's proposal meets the needs of coal producers. In summary, Aurizon Network's proposal would be a significant step forward, and the QRC appreciates Aurizon Network's efforts to introduce this mechanism and to reflect the feedback of stakeholders. However, the QRC considers that its proposed amendments would increase the usefulness of the short term transfer mechanism, resulting in a very efficient process which would promote greater utilisation of the network.

Feature of Short Term Transfer ("STT") as proposed by Aurizon Network	QRC Comment
STT mechanism operates in conjunction with (i.e. does not replace) existing transfer mechanisms.	Agree
Access agreements to be amended to provide for STTs (with agreement of access holder).	Agree
Paths transferred under STT mechanism will be treated as additional contracted paths ("TSEs") in the access agreement of the transferee on the same terms as existing paths.	Agree
Where a transferee has multiple 'generations' of paths (e.g. UT1 and UT3 paths) for an origin-destination, and additional paths are added to that origin-destination via a STT, the additional paths will be added to the most recent generation of paths already held by the transferee for that origin-destination (i.e. UT3 in the above example).	Agree
For longer term transfers, the paths taken on by the transferee will be contracted based on the current Standard Access Agreement terms (i.e. UT4). This is the same approach as applied in UT3.	Agree
Where a transferor has multiple 'generations' of paths (e.g. UT1 and UT3 paths) for an origin-	Agree

Feature of Short Term Transfer (“STT”) as proposed by Aurizon Network	QRC Comment
destination, and paths are transferred out of that origin-destination via a STT, the paths will be removed from the generation of paths nominated by the transferor.	
STT requests must be received at least 48 hours prior to the close of train orders for the next scheduling period.	Agree
Revenue from a transferred path will be counted as revenue of the transferee’s system or, where the transferee is within a group paying a differential tariff which is treated as a separate group for revenue cap purposes, the revenue will count as revenue of that group. To prevent this approach from having adverse impacts on other mines/Access Holders within the transferor’s system/pricing group, transfers will only be allowed within, and not between systems/pricing groups. For example, a STT of a path held by a GAPE Access Holder to a Newlands Access Holder would not be allowed.	Seeking amendment to Aurizon approach. This constraint on STTs should be addressed in order to maximise the efficiency benefits of the mechanism. We suggest that this issue can be dealt with by allocating the revenue earned on the transferred path to the transferor’s pricing group. We understand that Aurizon is considering the feasibility of this approach.
Transfers on the same route, for a shorter haul, with a common destination, would be pre-approved.	Agree
Transfers on the same route, for a longer haul, with a common destination, would receive approval, confirmed within 48 hours, if there is “Accessible Capacity” within the additional segments required by the transferee.	Agree
Short term transfers to be limited to three months duration	Agree. This is useful despite the lack of any prohibition on repeating the same transfer, because each new transfer provides an opportunity for Aurizon Network to apply certain criteria/tests to the approval (discussed below).
Short term transfers should be used to promote use of paths and not be used for other purposes, such as transferring to a shorter haul to reduce take or pay costs.	Agree. Aurizon proposes that STTs will be rejected if Aurizon considers that the transferred path is unlikely to be used, taking into account (among other things) any past history of a similar transfer not

Feature of Short Term Transfer (“STT”) as proposed by Aurizon Network	QRC Comment
	being used by the transferee. QRC supports this suggestion.
Transfer fees will not apply to short term transfers	<p>Agree. The STT mechanism promotes path usage and therefore is intended to increase Access Charge revenue. While transfers to a shorter haul may involve a theoretical loss of revenue (and potentially increase future Access Charges due to revenue cap shortfalls) this concern is mitigated by the following considerations:</p> <ul style="list-style-type: none"> <li>• AT2 (per path) and AT4 (per tonne) revenue is not reduced due to a transfer to a shorter haul. Of the other reference tariff elements, only AT3 is subject to TOP. Therefore the maximum revenue loss compared to the path being retained by the transferor and being subject to TOP relates to AT3 being collected over a shorter distance. This may well be offset by the additional AT1 and AT5 revenue received by ensuring that the path is used.</li> <li>• Had the path been retained by the transferor and not used, it is possible that the TOP applied would be less than the maximum possible TOP, due to: <ul style="list-style-type: none"> <li>– The system trigger test, which often reduces take or pay to nil.</li> <li>– Lower TOP charges under UT1 agreements.</li> <li>– Capping of TOP under UT2 and UT3 agreements.</li> </ul> </li> <li>• Higher utilisation of paths may help to spread fixed costs at the ports.</li> </ul>

## 4 Network Management Principles

The mark-up of Schedule G which reflects the amendments proposed by the QRC are set out separately in the mark-up document titled “Schedule G – Network Management Principles” (**mark-up**).

The key changes proposed by the QRC in that mark-up are as follows:

- Removing the blanket caveat on Aurizon Network’s obligation to provide information in accordance with Schedule G based on any confidentiality

obligations, Aurizon Network's obligations under Part 3 of the Undertaking or any other obligations under an access agreement. The QRC considers this restriction to be unnecessarily general and to undermine the purpose of the network management principles.

- Removing some of the discretion and subjectivity afforded to Aurizon Network in favour of objective criteria as well as requirements for Aurizon Network to act reasonably in making various decisions.
- Reinstating the UT3 requirement for Aurizon Network to update the master train plan no less than annually. The QRC considers that it is important that the master train plan is updated regularly to ensure its accuracy.
- Deleting the new clause proposed by Aurizon Network in the 2014 DAU which seeks to prevent Aurizon Network from incurring any liability provided it has made a good faith and reasonable attempt to comply with the relevant provisions of Schedule G. Aurizon Network should not be relieved of a breach simply because in its failure to comply it was using good faith.
- Reinstating the application of the daily train plan to performance targets reported on under Part 10 of the Undertaking. The QRC considers the daily train plan should continue to be used as base information for performance monitoring. This proposed amendment supplements the QRC's amendments to Part 10.

# 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 the 2014 DAU.

Part 8 deals with some of the most crucial aspects of UT4. Network planning and development, the expansion process and Aurizon Network’s funding obligations are key elements to the provision of access.

Through extensive consultation, the QRC and Aurizon Network have agreed amendments in respect of the extent of Part 8 which provides for the expansion process, except in relation to Aurizon Network’s funding obligations. The key improvements to the expansion process provided for by the 2014 DAU compared to the 2013 DAU, and in relation to which the QRC and Aurizon Network have reached an agreed position, are summarised in the table set out in Section 3 of this Part 8 submission.

The QRC considers those key improvements to have gone a long way to creating a process for studying, scoping and agreeing on an expansion which is prescriptive, objective and mechanical. However, the QRC is concerned that these improvements are undermined by the lack of funding options under the 2014 DAU. The QRC maintains that UT4 should contain a meaningful and practical suite of options for funding of expansions and Aurizon Network funding at the regulated WACC must be a key element of that suite. The QRC’s position on Aurizon Network’s funding obligations remains unchanged from its Main Submission on the 2013 DAU (10 October 2013). For ease of reference, the QRC has repeated that view (to the extent applicable) in Section 2 below.

The QRC also considers the network planning framework under the 2014 DAU still requires substantial improvement. In particular, the QRC proposes:

- the review of capacity and the system operating parameters needs to be more descriptive and should include a true independent review mechanism; and
- the significant discretion afforded to Aurizon Network in respect of the acceptance of capital expenditure projects should be removed.

## 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 funding commitment contained in the undertaking;
- (b) an efficient funding option for small-medium sized projects which are beyond any limits of Aurizon Network’s voluntary commitment;
- (c) SUFA; and

- (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 of the QRC's Main Submission on the 2013 DAU (10 October 2013), 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>1</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 framework which is still in development and remains untested.

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

<sup>1</sup> Please refer to page 47 of Aurizon Network's investor briefing of 29 April 2013.

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:

- (a) Develop an effective suite of funding options as described above in the earliest possible timeframe.
- (b) 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.

### 3 Expansion Process

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

The QRC has engaged in consultation with Aurizon Network in respect of the Expansion Process since Aurizon Network’s submission of the 2013 DAU. Through that engagement, Aurizon Network and the QRC have reached an agreed position in relation to the Expansion Process, except to the extent of Aurizon Network’s funding obligations.

The QRC and Aurizon Network’s agreed position in relation to the Expansion Process is reflected in Aurizon Network’s 2014 DAU (from clause 8.1 to clause 8.10).

In addition to the agreed drafting reflected in clause 8.1 to clause 8.10 of the 2014 DAU, the QRC proposes an additional minor amendment. This minor amendment is reflected in the mark-up document titled “Part 8.1 – Expansions” (**Part 8.1 Mark-up**).

#### 3.1 Improvements included in Aurizon Network’s 2014 DAU

The QRC considers Aurizon Network has made a number of improvements in the 2014 DAU based on consultation with the QRC and feedback from other stakeholders on the 2013 DAU in respect of expansions.

The following table summarises the key improvements reflected in the expansion framework provided for under the 2014 DAU as compared to the 2013 DAU.

#### 2013 DAU Position

#### Improvement reflected in the 2014 DAU

##### 1 Funding an expansion

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**2013 DAU Position****Improvement reflected in the 2014 DAU**

Aurizon Network is under no obligation to fund an expansion unless it has agreed to do so (in its discretion).

Aurizon Network is able to impose additional conditions outside the terms of Part 8.

Aurizon Network is entitled to enter into an agreement with an access seeker to fund an expansion or customer specific branch line outside the terms of Part 8.

Aurizon Network is obliged to construct or permit an expansion:

- that is fully funded by the particular funding users, Aurizon Network or by both the funding users and Aurizon Network; and
- for which Aurizon Network and the relevant parties have entered into SUFA agreements, a commercial terms document and/or an access agreement.

Aurizon Network retains the right to enter into an agreement with an access seeker to fund an expansion outside the terms of Part 8 provided that the agreement does not:

- unfairly prejudice any other access seeker who is seeking capacity to be created by an expansion or customer specific branch line; or
- affect the priority of allocation of capacity between access seekers.

**2 Legitimate business interests**

Aurizon Network is not required to fund, construct or permit an expansion that is not in accordance with its “legitimate business interests”.

The scope of the “legitimate business interests” test has been narrowed. It is now only relevant to disputes that are referred to the QCA.

The QCA in resolving a dispute must have regard to:

- Aurizon Network’s legitimate business interests; and
- the legitimate business interests of the access seekers.

**3 Sequential expansions**

Aurizon Network has a broad discretion to review and reallocate capacity in expansions later in the sequence.

Aurizon Network and access seekers cannot enter into later agreements for an expansion until earlier agreements have become unconditional.

Aurizon Network is only permitted to reallocate capacity between access seekers in relation to sequential expansions where:

- an access seeker for whom capacity is proposed to be created has entered into access agreements, commercial terms or user funding agreements that are likely to become unconditional at least 90 days before the same agreements of an access seeker earlier in the sequence; or
- there has been a delay in the expected date

**2013 DAU Position****Improvement reflected in the 2014 DAU**

on which an access seeker allocated to a proposed expansion earlier in the sequence can use their access rights and another access seeker later in the sequence is able to utilise those rights at least 90 days earlier.

Access seekers who disagree with a proposed reprioritisation of capacity may refer the matter to the QCA for determination.

**4 Demand assessments**

Aurizon Network can from, time to time, determine whether there is, or likely to be, sufficient demand for an expansion.

Aurizon Network must commence a demand assessment where:

- the operator of an existing or proposed coal terminal informs Aurizon Network that it has commenced a process to expand its existing coal terminal or build a new coal terminal;
- an access seeker submits an access application that Aurizon Network concludes cannot be satisfied without an expansion and that access seeker requests a concept study for that expansion; or
- an access seeker makes a written request to Aurizon Network to conduct a demand assessment.

An access seeker can dispute:

- the scope of information to be considered in a demand assessment by referring the matter to the QCA; and
- the outcome of a demand assessment by referring the matter to an expert.

**5 Concept studies**

Aurizon Network will undertake concept studies where it considers it appropriate to do so.

Aurizon Network must promptly undertake a concept study following the completion of a final demand assessment.

Aurizon Network must fund all concept studies unless an access seeker agrees to fund the concept study. If an access seeker funds a concept study, Aurizon Network must not provide that access seeker with any additional benefit or advantage that it would not otherwise have been entitled to.

**6 Pre-feasibility Studies**

If Aurizon Network determines that there is, or

Following a concept study, Aurizon Network

**2013 DAU Position****Improvement reflected in the 2014 DAU**

is likely to be, sufficient demand it must undertake a pre-feasibility study only if:

- Aurizon Network, in its discretion, chooses to fund the pre-feasibility study; or
- the relevant Access Seeker enters into an agreement with Aurizon Network to fund the study and that relevant agreement is unconditional.

must promptly undertake a pre-feasibility study if:

- one or more potential pre-feasibility funders chooses to fund the pre-feasibility study;
- the potential pre-feasibility funders and Aurizon Network agree that Aurizon Network should fund the pre-feasibility study; or
- Aurizon Network chooses to fund the pre-feasibility study and no unconditional studies funding agreement comes into effect within 40 days.

Generally, only producers and consumers of coal are entitled to fund a pre-feasibility study. An operator is only permitted to fund a pre-feasibility study if it is acting for the benefit of a customer. If Aurizon Network funds the pre-feasibility study, it must not give a particular access seeker any rights that it would not otherwise have been entitled to had Aurizon Network not funded the pre-feasibility study.

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## **7 Criteria for selecting pre-feasibility study funders**

The opportunity to fund a pre-feasibility study will be given by Aurizon Network to access seekers who satisfy the following requirements:

- they have secured, or are reasonably likely to secure unloading facility capacity rights;
- they have secured, or are reasonably likely to secure rail haulage agreements;
- they have sufficient facilities; and
- the anticipated output from a mine is sufficient to support full utilisation of that mine.

The criteria for selecting pre-feasibility study funders has been adjusted so that potential funders that are not at an advanced stage of their project or that do not have the detailed information contemplated by the 2013 DAU drafting, are not precluded from providing funding. For example, a producer of coal can provide funding if it:

- has at least an exploration permit for coal;
- has a credible program for the development of its mine; and
- is diligently developing its mine.

Any access seeker that disagrees with Aurizon Network's selection of funders may refer the matter to the QCA. Any disputes arising in relation to the scope of the pre-feasibility study or the completion of schedules in a studies funding agreement may also be referred to the QCA.

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## **8 Feasibility studies**

If Aurizon Network determines that there is (or is likely to be) sufficient demand for an expansion it must undertake a feasibility study

Aurizon Network must undertake a feasibility study if one or more of the potential feasibility funders agree to fund the feasibility study.

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**2013 DAU Position****Improvement reflected in the 2014 DAU**

only if:

- Aurizon Network, in its discretion, chooses to fund the pre-feasibility study; or
- the relevant access seekers agreeing with Aurizon Network decide to fund the study.

Feasibility studies must be funded by access seekers who are the ultimate customer. They must not be funded by Aurizon Network or an operator acting as an access seeker (except where a customer has nominated the operator, in writing, to act on its behalf).

### 9 Criteria for selecting feasibility study funders

The following access seekers are to be given the opportunity to fund a feasibility study:

- access seekers with capacity Shortfall access applications; and
- those access seekers that Aurizon Network decides are best able to utilise the capacity expected to be created by the expansion.

If Aurizon Network is unable to decide between access seekers then Aurizon Network will consider its 'legitimate business interests' in making a choice of funder.

The criteria for selecting feasibility study funders is the same as that for selecting pre-feasibility study funders. However, access seekers that were offered an opportunity to fund a pre-feasibility study but did not become a pre-feasibility study funder are excluded.

Aurizon Network does not have a broad discretion to choose who funds a feasibility study.

A dispute that arises in relation to the scope of the feasibility study or the completion of schedules in a studies funding agreement can be referred to the QCA.

### 10 Target capacity of future expansion

No specific clauses dealing with:

- Aurizon Network's quantification of the total capacity to be created by the proposed expansion; and
- the procedure to be followed if the total capacity does not meet the combined demand from all access seekers.

Aurizon Network will determine the target amount of capacity for the proposed expansion having regard to:

- the total indicative demand for capacity;
- the potential scope of the proposed expansion;
- the capacity of the relevant port or unloading facility; and
- any potential staging of expansions.

Aurizon Network must notify all the relevant access seekers of the target capacity, total indicative demand and reasons why a higher target capacity has not been proposed (if applicable).

If the target capacity is expected to be insufficient, Aurizon Network will decide who will be given the opportunity to fund the particular feasibility study having regard to:

- those access seekers who meet the criteria for funding a feasibility study to a greater extent;
- the access seekers who funded the pre-

**2013 DAU Position****Improvement reflected in the 2014 DAU**

feasibility study;

- maximisation of the allocation of capacity; and
- maximisation of the duration of the expected access.

An access seeker may dispute Aurizon Network's determination of target capacity and/or the selection process by referring the matter to the QCA.

**11 Withdrawal of Provisional capacity Allocation**

If Aurizon Network withdraws a provisional capacity allocation, it can take whatever action it considers appropriate in the circumstances including:

- reallocation of that provisional capacity to another person;
- ceasing to further consider that expansion; or
- reprioritising the sequence of expansions.

If Aurizon Network withdraws a provisional capacity allocation, it must allow the relevant feasibility funder a reasonable opportunity to explain why Aurizon Network should not withdraw the provisional capacity allocation. If Aurizon Network still withdraws its provisional capacity allocation, notice and reasons must be given to the feasibility funder.

The feasibility funder is entitled to refer the matter to the QCA.

Aurizon Network must also, to the extent feasible, seek a replacement feasibility funder based on the criteria for selecting feasibility funders.

**12 Step-in where Aurizon Network fails to enter into Studies Funding Agreement**

No provisions relating to Aurizon Network's failure to enter into studies funding agreements.

If either:

- Aurizon Network fails to enter into a studies funding agreement or delays entering into a studies funding agreement; or
- there is an expectation that the relevant pre-feasibility study or feasibility study cannot be completed by Aurizon Network 60 days after the expected completion of that study,

an affected access seeker may notify Aurizon Network of the alleged failure and proceed to refer the matter to the QCA if necessary.

The QCA may determine that a nominee of the access seeker 'steps in' and completes the relevant study.

Aurizon Network is obliged to adopt the relevant study output however has a right to seek a review of the scope of that relevant study by referring the matter to the QCA.

**2013 DAU Position****Improvement reflected in the 2014 DAU****13 Inclusion of expansion cost in Regulated Asset Base / SUFA provisions**

No relevant provisions.

The RAB will include user funded expansions.

After executing the first user funding agreement or in the event Aurizon Network and the funding users are unable to agree on a user funding agreement:

- Aurizon Network will review SUFA; and
- consult with funders about the workability of SUFA.

**14 Optimisation risk**

No relevant provisions.

Where Aurizon Network is funding all (or part) of the cost of an expansion, Aurizon Network will apply to the QCA for pre-approval as to the prudence of the:

- scope of the expansion;
- standard of works for the expansion; and
- proposed cost of the expansion.

The actual cost of the expansion up to the pre-approved proposed cost will automatically be included in the RAB.

Any actual costs above the pre-approved cost will need to be subsequently approved by the QCA for inclusion in the RAB.

If the QCA does not pre-approve the proposed cost of expansion, Aurizon Network is not obliged to fund the expansion (in the absence of user funding).

Where the QCA determines the scope of works for an expansion and construction of the expansion results in a capacity shortfall, Aurizon Network will calculate the capacity shortfall that would have existed had the original scope of work (proposed by Aurizon Network) been adopted. If the calculated shortfall:

- is less than the constructed capacity shortfall, then Aurizon Network bears no further risk;
- is equal to or greater than the constructed capacity shortfall, then Aurizon Network will fund the future shortfall expansion.

**15 Capacity shortfalls**

**2013 DAU Position****Improvement reflected in the 2014 DAU**

Aurizon Network is only required to comply with the capacity shortfall provisions to the extent that such compliance is consistent with Aurizon Network's commercial objectives.

Aurizon Network does not have a broad discretion to decide whether to fund a capacity shortfall.

Where a shortfall expansion is required as a result of a capacity shortfall:

- if the earlier expansion was funded by Aurizon Network, Aurizon Network will bear the cost of the shortfall expansion;
- if the earlier expansion was partly funded by Aurizon Network, it will only bear the proportionate cost of the shortfall expansion in accordance with the earlier expansion;
- if the earlier expansion was not funded by Aurizon Network, it will bear no liability;
- if the capacity shortfall was caused by a default, negligent act or omission of Aurizon Network, Aurizon Network will bear the cost of the shortfall expansion.

A conditional access holder is entitled to dispute a grant of conditional access rights by referring the matter to an expert.

**16 Additional protections**

Minimal protections for access seekers and customers.

Aurizon Network has broad discretionary powers in relation to expansions.

Aurizon Network is not permitted to discriminate in the performance of its obligations between access seekers (or customers) on the basis that an access seeker (or customer) has funded a pre-feasibility study, a feasibility study or an expansion.

Aurizon Network must meet its obligations under Part 8 in respect of pre-feasibility studies, feasibility studies and expansions, despite any resource constraints on Aurizon Network.

Where there is any dispute under Part 8, Aurizon Network must identify all the parties that will be bound by the outcome of the dispute and provide them with written notice of the dispute. This will ensure that a customer is notified of any dispute lodged by an access seeker acting on its behalf.

**3.2 SUFA**

The expansion process prepared by the QRC and Aurizon Network does not take account of SUFA. In particular, it does not provide for an expansion pre-approval process.

There are some aspects of the expansion process section that will need to be modified. For example, the current draft provides that where the scope of a study project or expansion is determined by an expert (through dispute resolution) the access seeker bears the risk of the adequacy of such scope. For user funded projects it will be necessary to agree a scope. There will be an incentive for Aurizon Network to over scope and as a result, there is a high likelihood of dispute and need for dispute resolution. If user funders were to bear the risk of adequacy of project scope determined by an expert there would be an incentive for Aurizon Network to dispute all scope. That is not practical or fair. This aspect of the expansion process will require amendment. The draft included in this submission does not include this change.

## 4 Network development, capacity assessment and voting

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The mark-up of the second half of Part 8 (covering network development, capacity assessment and voting) which reflects the amendments proposed by the QRC is set out separately in the mark-up document titled “Part 8.2 – Network development” (**Part 8.2 Mark-up**).

Some of the amendments proposed in the Part 8.2 Mark-up have been discussed, and developed in consultation, with Aurizon Network. The QRC understands that Aurizon Network agrees to the Part 8.2 Mark-up except to the extent otherwise indicated in that document.

### 4.1 System Operating Parameters

The QRC has proposed a number of amendments to the framework under the 2014 DAU dealing with the system operating parameters.

Given the importance of the system operating parameters to the assessment and review of capacity, the QRC considers that the initial and reviewed system operating parameters should require QCA approval. Aurizon Network should also be required to undertake a review of the system operating parameters in specified circumstances.

The 2014 DAU provides for Aurizon Network to make publically available the most current system operating parameters. The QRC agrees with this position but proposes to extend this disclosure requirement to the outcomes of any review of the system operating parameters.

The QRC proposes that where Aurizon Network undertakes a review, it should promptly make the outcomes of that review available to all relevant access holders. This amendment is required to ensure transparency in relation to the system operating parameters, a necessary element to equipping access holders with the means to meaningfully comment on capacity.

### 4.2 Capacity Review

The QRC considers the capacity review provisions under the 2014 DAU still require substantial amendment.

#### (a) Requirement to undertake a capacity review

The 2014 DAU requires Aurizon Network to undertake a capacity review if the system operating parameters are varied. Aurizon Network should also be required to undertake a capacity review if it is aware of a change in below rail which is not otherwise reflected in the system operating parameters (except to the extent of any short-term, temporary or transient changes in capacity).

Aurizon Network has also attempted to provide additional information as to what a capacity assessment or review would include in the 2014 DAU. The QRC supports this proposal, however, the QRC is concerned that the elements addressed by Aurizon Network are too limiting. To address this concern, the QRC proposes to refer to a capacity review including ‘all other matters consistent with Good Engineering Practices’.

The QRC also proposes that the 2014 DAU be amended to provide for the minimum requirements of the outcomes of a capacity review. These outcomes should include the specification of ‘capacity’ and the differences between committed capacity and total capacity (which includes both planned and existing capacity). This amendment will assist to focus the outcome of a capacity review and reinforce the purpose of a capacity review.

**(b) Independent review of the outcome of a capacity review**

In the 2014 DAU Aurizon Network has included the ability for access holders to require an independent review of a capacity assessment. The QRC strongly supports the concept of an independent review. However, the QRC considers the review right proposed by Aurizon Network requires substantial amendment.

As drafted, the right to obtain an independent review does not lead to any particular outcome apart from the provision of an expert report. That expert report appears to be provided for information purposes only and has no effect on the actual outcome of a capacity review. The QRC also questions the true independence of a review in circumstances where Aurizon Network itself engages the expert.

The QRC proposes that the independent review mechanism be amended to provide for:

- QCA approval of the expert appointed and requirements as to the independence, experience and qualifications of the expert.
- The ability for the expert to determine what the capacity review outcome should have been, rather than only considering the reasonableness of Aurizon Network’s determination. The purpose of an independent review is significantly undermined if the expert’s scope is restricted to assessing Aurizon Network’s capacity assessment. An expert should be free to make its own independent determination as to the capacity review.
- Expanding the scope of the expert determination to include a review of the system operating parameters.
- An outcome whereby the expert determination is deemed to replace Aurizon Network’s capacity assessment. This outcome will provide value and substance to the capacity review process unlike an expert report issued only for information purposes.

### 4.3 Network Development Plan

As reflected in its Main Submission on the 2013 DAU (10 October 2013), the QRC is very supportive of the concept of a network development plan. The QRC acknowledges that Aurizon Network has attempted to make a number of changes in the 2014 DAU to reflect the concerns of industry as to the uncertainty of the network development plan. Despite this, the QRC considers uncertainty still exists particularly in relation to the purpose and content of the network development plan. For this reason, the QRC proposes that the 2014 DAU be amended to include a statement of the objective of the network development plan, better describe the content of the network development plan and identify the link between the network development plan and the network management principles and system operating parameters. This will assist stakeholders to better understand the instrument and provide comfort in the level and type of information that could be expected to be reflected in that document.

The QRC also proposes that the 2014 DAU be amended to require Aurizon Network to undertake a review of the network development plan in specified circumstances and allow access holders to require a peer review in relation to the preparation or development of the network development plan. This will assist in ensuring the relevance and accuracy of the network development plan.

#### 4.4 Acceptance of capital expenditure projects

Subject to the QRC's review of the proposed expansion pre-approval process contemplated as part of the QCA's SUFA discussion paper, the QRC has proposed a number of amendments to the user voting process as reflected in its Part 8.2 Mark-up.

In particular, the QRC proposes the following amendments to the user voting process:

- Removal of the requirement for a user to provide reasons where it chooses to vote 'no'. The QRC has considered removing the ability for users to vote on the scope of a project as it considers this is often a matter best left for the QCA. Rather than removing the ability for a user vote on scope altogether, the QRC has removed the requirement for a user to provide reasons for voting 'no'. This will allow a user to vote 'no' where it considers the matter is best referred to the QCA for determination. The QRC also considers that Aurizon Network should not be afforded any discretion in excluding votes from the voting process due to a failure to provide reasons or because of the substance of the reasons provided.
- A failure to respond to a vote being excluded from the determination of the outcome of a vote altogether rather than deeming that failure to be a 'yes' vote. The QRC does not support Aurizon Network's proposal for a failure to vote to be deemed a 'yes' vote. The QRC's experience is that users often choose not to vote on a project because they are unsure whether the project may actually be necessary due to a lack of information. For this reason, users are reluctant to vote no, however equally, that failure to vote should not be deemed to be a 'yes' vote. It is more reasonable for an interested participant who fails to vote to be removed from the determination of the outcome of that vote. The QRC's opinion is that only those users with an opinion (i.e. by voting 'yes' or 'no') should be included in the determination of the outcome of a vote.
- Including a requirement for Aurizon Network to act reasonably in carrying out the voting process and to provide comprehensive information throughout.
- Removing any restrictions on Aurizon Network's obligation to provide information based on any confidentiality obligations. The QRC considers such caveats to be unnecessary and to undermine the transparency of the voting process.
- Deeming any vote to be invalid and ineffective where that vote did not substantially comply with the voting process (based on an objective assessment).

# Part 9 – Connecting Private Infrastructure

## 1 Improvements included in Aurizon Network’s 2014 DAU

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Aurizon Network’s 2014 Draft Access Undertaking included some improvements which reflected feedback of the QRC and other stakeholders on the 2013 Draft Access Undertaking.

The primary change made by Aurizon Network involved permitting a private infrastructure owner who is not an “Access Seeker” to invoke Part 9. This is very useful, as with development such as the Surat Basin Railway the party seeking to connect to the Aurizon Network Rail Infrastructure will be the private infrastructure owner and not the access seeker.

## 2 Further improvement sought

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The QRC welcomes the changes included by Aurizon Network in Part 9 of the 2014 DAU. However, the QRC seeks further improvements to Part 9.

The QRC’s mark-up of Part 9 against the 2014 DAU is reflected in the mark-up document titled “Part 9 – Connecting Private Infrastructure” (**mark-up**). The changes proposed in this mark-up have been discussed, and developed in consultation with, Aurizon Network. The QRC has sought to indicate, in the mark-up, its understanding of the extent to which Aurizon Network supports the proposed changes.

The key proposed changes, and reasons for the changes, are explained below. This is not an exhaustive list of the changes proposed in the mark-up. To the extent that the reason for any of the changes not discussed below is unclear to the QCA, we would be pleased to provide further explanation.

Key changes proposed by the QRC are as follows:

- **Clause 9.1(c):** The test for whether the connection will reduce the capacity of the rail infrastructure should be after completion of any planned expansion.
- **Clause 9.1(e)(iii):** Part 9 provides that Aurizon Network has the right to construct connecting infrastructure. The QRC supports this. Part 9 and the Standard Rail Connection Agreement also provides that Aurizon Network’s construction of the connecting infrastructure will be undertaken in accordance with a separate construction agreement to be agreed between the parties. The QRC consider this to be a significant shortfall in the process provided for in Part 9. The QRC propose that a standard construction agreement be separately attached to the undertaking or alternatively that the complete terms and pricing principles for construction be set out in the Standard Rail Connection Agreement (perhaps as a schedule). Requiring the parties to agree the terms of the agreement (with the background of limited principles in the Standard Rail Connection Agreement) will result in delay and potential dispute. This undermines the benefit of having a Standard Rail Connection Agreement.

**Clause 9.1(f):** The QRC have proposed a new paragraph (f). The paragraph requires Aurizon Network to use reasonable endeavours to agree upon a Rail Connection Agreement and if necessary procure land consents (at the cost of the party seeking the connection). This paragraph is required in order to provide a trigger for the commencement of negotiations.

## Part 10 – Reporting

### 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 the 2014 DAU, as captured in Part 10 (**Part 10**).

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

- 1 the true 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 potential relaxation of Aurizon Network’s operational reporting requirements as contemplated by the 2014 DAU;
- 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 the 2014 DAU to be approved by the QCA in advance;
- 4 the inclusion of a mandatory annual audit of Aurizon Network’s reporting obligations under the 2014 DAU 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 the 2014 DAU Part 3 (**Part 3**) and a separate ability for the QCA to require an audit of those obligations as required;
- 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 the 2014 DAU. 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 2014 DAU reporting obligations but does not seek to limit the QRC’s Mark-up.

## 2.1 Quarterly network performance reporting

The obligation for Aurizon Network to provide quarterly network performance reports in UT3 was relaxed in the 2013 DAU to require annual reporting only. The QRC acknowledges Aurizon Network’s amendments regarding reinstatement of quarterly reports in the 2014 DAU, however does not support the potential 30 day time extension allowed to Aurizon Network in relation to its reporting obligation where there are coordination implications related to ASX reporting policies. The QRC again seeks the true reinstatement of the quarterly reporting obligations contained in UT3.

Aurizon Network has sought to explain the relaxation in its operational reporting obligations 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).

Although the QRC recognises the importance of streamlined corporate governance, it does not consider a shift to reporting with ASX coordination implications 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 network 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 reporting of network performance information should not be subject to coordination with ASX reporting policies.

## 2.2 Public disclosure of access agreements

The 2013 DAU retained 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, the 2013 DAU significantly changed 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 sought 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. The QRC holds the view that Aurizon Network’s amendments to the relevant provisions of the 2014 DAU do not sufficiently address the QRC’s concerns.

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 2014 DAU 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 continues to support the inclusion of a requirement in the 2014 DAU for the format of all reports required under the 2014 DAU to be approved by the QCA in advance. This requirement existed in part under UT3 and will ensure consistency of reporting for the term of the 2014 DAU.

## 3 Auditing

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This section clarifies the QRC's position in relation to certain aspects of the 2014 DAU 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 the 2013 DAU removed all ongoing obligations for annual audits contained in UT3. Instead, under the 2013 DAU audits were triggered at the request of the QCA. Aurizon Network suggested that *"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 proposed that annual audits of Aurizon Network's reporting and ringfencing obligations (discussed further in the Part 3 submission) be undertaken under the 2013 DAU. This proposal has not been adopted by Aurizon Network in the 2014 DAU. The QRC considers that the benefits of increased transparency will outweigh any incremental increase in Aurizon Network's auditing costs and maintains its position on this issue in respect of the 2014 DAU.

### 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 section 3.4 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. Aurizon Network has indicated it *"is willing to discuss this proposal with the QCA."* The QRC would welcome the opportunity to discuss this proposal with the QCA if the QCA considers there is benefit in doing so.

### 3.3 Annual conflicts audit

As outlined at section 2.2 above and identified in the Part 3 submission, the QRC has a number of concerns regarding the efficacy of the 2014 DAU ringfencing obligations. The QRC considers that an audit of Aurizon Network's compliance with its obligations under Part 3 and other issues for which the QCA reasonably believes an audit is necessary, will function as an appropriate mechanism to address these concerns. For clarity, the QRC

notes that the auditor may take into account Aurizon Network's compliance with any relevant internal procedures in conducting the audit.

### **3.4 QCA appointment of auditors**

The requirement for QCA approval of the Aurizon Network selected auditor (or auditors) has been omitted from the 2014 DAU. 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 the 2014 DAU.

The QRC does not consider that there is any basis to exclude the QCA involvement from the appointment of auditors in the 2014 DAU. 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 maintains that it is not appropriate for the auditor to have any duty to Aurizon Network.

# Part 11 – Dispute resolution and Decision Making

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to the dispute resolution framework under the 2014 DAU, as captured in the 2014 DAU 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 that any costs imposed by the safety regulator be borne by the parties “in such proportion as the QCA determines”;
- 4 the removal of the requirement for the QCA to provide the parties to a Dispute with a draft determination of that Dispute and to give those parties reasonable opportunity to make relevant submissions in relation to the draft determination, including in relation to whether Aurizon Network’s compliance with the draft determination is reasonably possible without breaching the land or rail infrastructure tenure of Aurizon Network;
- 5 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 2014 DAU 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. The 2014 DAU 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 2014 DAU 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 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 the 2014 DAU 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.

## **2.3 Determination by the QCA**

The QRC submits that it is inappropriate for the 2014 DAU 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 the 2014 DAU and doing so may lead to inconsistency. To the extent that there is any discrepancy between Part 11 and the QCA Act, the QRC's view is that the provisions of the Act should take precedence.

## **2.4 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 the 2014 DAU 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 2014 DAU 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.

## **2.5 Draft determination of a Dispute - breaching the land or rail infrastructure tenure of Aurizon Network**

The 2014 DAU contains a new provision which requires the QCA to provide the parties to a Dispute with a draft determination of that Dispute. The QCA is also required to give those parties reasonable opportunity to make relevant submissions in relation to the draft determination, including in relation to whether Aurizon Network's compliance with the draft determination is reasonably possible without breaching the land or rail infrastructure

tenure of Aurizon Network. The QRC considers these requirements to be unreasonable and is in favour of their removal as:

- the Decision of the QCA will be delayed while the above process is completed and this is not conducive to an efficient dispute resolution framework;
- the contemplation of Aurizon Network's non-compliance is based on a mere possibility; and
- no concession is made for any potential fault of Aurizon Network.

The QRC notes that 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.

# Schedule A and B – Preliminary Information , Additional and Capacity Information and Access Application information

## 1 Overview

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This part of the submission outlines the QRC’s position in relation to:

- 1 the provision of preliminary, additional and capacity information in the context of the initial inquiries for access; and
- 2 the information requirements for access applications for new access rights, renewals and transfers.

The mark-up of Schedule A and Schedule B reflecting the amendments proposed by the QRC are set out separately in the mark-up documents titled “Schedule A – Preliminary, Additional and Capacity Information” and “Schedule B – Access Application information requirements”.

Schedule A and Schedule B supplement the negotiation process (Part 4) and capacity allocation mechanisms (Part 7) under UT4. The QRC’s proposed amendments in respect of those schedules largely reflect consequential amendments which flow on from the amendments proposed by the QRC in respect of Part 4 and Part 7.

### 1.1 Schedule A – Preliminary, Additional and Capacity Information

The 2014 DAU includes new carve outs with respect to Aurizon Network’s obligations to provide preliminary, additional and capacity information. These carve outs seek to relieve Aurizon Network of its obligation to provide information where it would be unable to do so without breaching any confidentiality obligations.

The QRC disagrees with these carve outs and considers the amendments to reflect an attempt by Aurizon Network to afford itself an “out” to its obligations. Aurizon Network’s obligations to provide preliminary, additional and capacity information are important to ensure access to and transparency of information. Making such obligations subject to any confidentiality obligations of Aurizon Network defeats those objectives.

### 1.2 Schedule B – Access Application information requirements

Schedule B of the 2014 DAU includes a number of amendments compared to the 2013 DAU. The majority of these amendments reflect changes that have been made to Part 4 and Part 7 based on industry feedback on the 2013 DAU.

In line with those amendments, the QRC has recommended a number of further changes to Schedule B which flow on from amendments which have been proposed in respect of Part 4 and Part 7 in this submission. The key changes proposed by the QRC are summarised as follows:

- Requiring a railway operator who is seeking access rights to be used for a person other than itself (ie a proposed customer), to provide evidence that the proposed customer agrees to the railway operator acting on its behalf.
- Aligning the timing of an access application with the extent of information that generally exists in respect of an access seeker’s ability to fully utilise access rights. For example, an access seeker should only be required to demonstrate a

'reasonable likelihood' of having sufficient facilities to fully utilise the access rights sought.

- Including a new factor concerning customer specific branch lines which an access seeker is required to provide information on when making an access application.
- Requiring an application for a transfer to provide Aurizon Network with the contact details for the transferor. This will facilitate Aurizon Network to confirm that a transfer is supported by both the transferee's customer (if applicable) and the transferor's customer (if applicable).

## Schedule E – Regulatory Asset Base

### 1 Comments on changes in 2014 Draft Undertaking

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Aurizon Network's 2014 DAU included a number of changes to Schedule E, compared to the version in the 2013 DAU. QRC's comments on these changes, and on further changes sought, are set out below.

The majority of the changes sought to this DAU were also requested in the QRC's response to the 2013 DAU. Further detail on the requested changes is set out in Schedule E of the QRC's Main Submission and Mark-up of the 2013 DAU (October 2013).

Clause	Summary	Comment
1.1	Generally disagree	<p>Aurizon Network has proposed that, where assets are disposed of at a value below the RAB value, the proceeds of sale will be deducted from the RAB. The QRC's suggestion that the value deducted should at least reflect a reasonable market value, or be subject to some obligation on Aurizon Network to conduct a prudent sale process, has not been addressed.</p> <p>Where assets are disposed of at a value above the RAB value, Aurizon proposes to retain 50% of the gain. We see no reason for the lack of reciprocity in this arrangement (if 100% of 'losses' on sales must remain in the RAB, 100% of gains should come out of the RAB).</p> <p>Where SUFA assets are sold at a premium above RAB value, the RAB is reduced by RAB value only, so that Aurizon or SUFA funders will retain the gain (the QRC is not sure whether the gain would flow to SUFA funders). Again, we see no reason why the RAB should not be reduced by the full value of the sale proceeds.</p> <p>Aurizon Network has added wording which excludes disposals relating to assets which are replaced from this clause. If the intention is that the sale proceeds in these circumstances is credited against the cost of the replacement asset, then we accept this exclusion. However, the undertaking should be clear on this point.</p> <p>Clause 1.1(b) allows Aurizon Network, subject to QCA acceptance, to select which RAB assets are reduced in value, but only to the extent of the reduction relating to 50% of the surplus over the RAB value. The undertaking should be clear that the portion of the proceeds up to the RAB value must be deducted from the value of the relevant (disposed) assets.</p>
1.2	Agree, but further changes required	<p>The QRC supports the amendment in this clause relating to additional information to be provided by the QCA when the QCA requires that the value of assets in the RAB to be reduced.</p> <p>The QRC seeks the reinstatement of the UT3 drafting regarding circumstances in which the QCA could require the RAB to be reduced, which included deterioration in demand such that charging regulated prices on the same asset base would lead to further reduction in demand, possibility of actual bypass, and excessive</p>

Clause	Summary	Comment
		deterioration of the Rail Infrastructure based on a Condition Based Assessment.
1.3	Agree	
1.4	Agree	
1.5	Disagree	<p>Aurizon Network has limited this clause to equity raising costs 'incurred by Aurizon Network'. This seems to place user funding at a disadvantage to Aurizon Network funded projects.</p> <p>It is not clear whether the intent of 1.5(b) is to add the equity raising costs to future allowable revenues, or to capitalise these costs against the relevant capital expenditure. The QRC considers that the costs should be capitalised into the value of relevant assets (including user funded assets).</p> <p>The QRC relies on the QCA to assess the reasonableness of the specified parameters in Clause 1.5(a)(v).</p>
No reference		UT3 contained, at Clause 1.5 of schedule E, an obligation on Network Aurizon to maintain the Rail Infrastructure in a fit for purpose state. This requirement should be reinstated.
2.1	Agree	Provision for customer acceptance of prudency has been amended to refer only to scope.
2.2	Agree	
2.3	Agree, but further changes required	The QCA should be able to invite and consider stakeholder input when assessing prudency.
2.4	Agree	Aspects of this clause require amendment. For example, the reference to "direct and indirect" determinations by experts should be removed. The clause should only operate where an expert is specifically asked to consider and opine on the prudency of scope, standard and cost, and not where they do so as an adjunct to another function.
2.5	No changes made	Aurizon Network should commit to prepare an asset management plan for approval by the QCA, and to periodically update the plan.

Clause	Summary	Comment
3.2	Agree, but further change required	<p>Under clause 3.2(a)(i), scope is deemed prudent if the project is for asset replacement and renewal expenditure and is in accordance with the asset management plan. This is acceptable only if additional drafting is added to clause 2.5 which:</p> <ul style="list-style-type: none"> <li>requires that the asset management plan includes sufficient information to determine prudence of scope, and</li> <li>establishes the process by which QCA approved prudence under the asset management plan.</li> </ul> <p>We suggest that it is preferable to assess prudence under clause 3.2, having regard to the extent to which a renewal is consistent with the asset management plan - this is already provided for under clause 3.2(d)(iv).</p> <p>Under clause 3.2(a)(ii), scope is deemed prudent if the project is access holder or customer specific and the scope has been accepted by the access holder or customer. This is not appropriate where the project or its inclusion in the RAB may impact on other access holders or customers. The QRC suggests this provision be deleted.</p>
4.2		<p>Refer to our comments on clause 3.2 regarding deemed prudence of expenditure which is consistent with the asset management plan. The standard of works should not be deemed prudent simply because the standard is consistent with an asset management plan, unless the requirements and approval processes for that plan are substantially expanded.</p>
8.0	Reinstate UT3 clause	A provision dealing with end of regulatory period condition based assessments should be reinstated.
n/a	Customer Specific Branch Line	The Undertaking (both in Schedule E and Part 6) should note that CSBL should not be included in the RAB, except if they cease to be CSBLs.

## Schedule F – Reference Tariff

### 1 Comments on changes in 2014 DAU

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Aurizon Network's 2014 DAU included a number of changes to Schedule F, compared to the version in the 2013 Draft Access Undertaking. The QRC's comments on these changes are set out below:

Clause	Summary	Comment
1.3(b)(vii)	Unsure of purpose and effect	The QRC is unclear as to the purpose and implications of this new clause. For example, it appears that if a train, during its journey between an origin and a destination, diverts from the most direct route (for example, for provisioning), then it is no longer a Reference Train Service. Therefore, a Reference Tariff no longer applies. This makes the tariff which will be applied to a significant portion of train services uncertain.
1.3(b)(viii)	Agree	Changes are similar to those suggested by the QRC and address the QRC's concern.
2.2(d)	Agree	Appears to address the QRC concern regarding the 2013 DAU.
2.2(e)	Agree	Change proposed by Aurizon Network is acceptable.
2.3(a)(v)	Agree	Pricing of cross system traffic has been amended based on the QRC's suggestions.
2.4	Generally Disagree	The QRC supports the amendment (Sch F, 2.4(j)) which provides that the system trigger test will not apply to take or pay in regard to Access Agreements to which an Expansion Tariff applies.  Other than for this change, the QRC's concerns regarding TOP calculations have not been addressed – see Part 2 of this Schedule F submission.
3.1-3.6	Generally Disagree	The QRC supports the following amendments: <ul style="list-style-type: none"> <li>deletion of the adjustment regarding environmental charges within electricity costs; and</li> <li>widening the group which the QCA may consider comments from so that Customers may provide input (3.3(k)).</li> </ul> Other than for these items, the QRC's concerns regarding Clause 3 (previously clause 4) of schedule F have not been addressed – see Part 3 of this Schedule F submission.

4.1-4.6	Agree	<p>The QRC supports the following amendments:</p> <ul style="list-style-type: none"> <li>the amendment to Clause 4.1(b) which allows the QCA to compel Aurizon to submit a reference tariff variation where a Review Event has occurred; and</li> <li>deletion of 4.3(b) and (c) of Schedule F of the 2013 DAU. This deletion will ensure that a change in prudent and efficient maintenance costs will only be a review event if the cost impact is greater than 2.5% of the overall allowance reflected in a Reference Tariff.</li> </ul>
6 - 7	Agree	<p>QRC supports the amendment allowing diesel trains to be Reference Trains, in 6.1(b)(iii) (Blackwater) and 7.1(b)(iii) (Goonyella).</p> <p>Note however that the inclusion of WIRP within the socialised Blackwater Reference Tariffs requires further consideration – see the discussion in Part D below.</p>

## 2 Take or Pay (Sch F, 2.4).

Item 2.3 of Schedule F of the QRC's October 2013 submission set out the QRC's views on the TOP arrangements proposed by Aurizon Network in the 2013 DAU. The concerns raised in that submission have generally not been addressed. The concerns are explained in detail in the QRC's October 2013 submission and are summarised below.

- The definition of Aurizon Network Cause is too wide for the purposes of TOP clauses. 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 an excuse 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.
- Aurizon Network proposes (Schedule F, 2.4(d)(i)(A)(1)) that the gtk used for the system trigger test will, in the case of UT1 Access Agreements only, exclude gtk's relating to train services to Wiggins Island. This special provision seeks to protect UT1 Access Holders (i.e. Aurizon Operations) from the impact of Aurizon Network's proposal to use a forecast for Wiggins Island tonnage (90% of contract) which Aurizon Network expects will not be achieved. We note that the QCA has now released, within its draft MAR decision, its draft views on forecast tonnages, including for Wiggins Island.

- To the extent that the forecast for Wiggins Island tonnage is not achieved in any year, this may increase the risk of TOP being triggered in the Blackwater system. In addition, the use of an unrealistic forecast, and the use of a different forecast for UT1 agreements (making it likely that UT1 TOP will not trigger), will increase the likely magnitude of TOP collections for UT2 and later agreements.
- In Schedule F, 2.4(g) Aurizon Network proposes to allocate any train services lost due to Aurizon Network Cause to UT1 Access Agreements. This is a further attempt to reduce UT1 TOP at the expense of TOP exposures under later Access Agreements.
- Aurizon Network’s proposal for ‘operator capping’ has not been removed or amended. Below is an extract of the QRC’s October 2013 submission on this topic:

*“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.”*

### 3 Annual Review of Reference Tariffs (Sch F, Clause 3)

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Item 4 of Schedule F of the QRC’s October 2013 submission set out the QRC’s views on this clause. Other than as noted in the table above, the concerns have not been addressed. The issues are summarised below.

- Aurizon Network faces minimal exposure to its own performance, and has not proposed any meaningful incentive mechanisms in this undertaking.
- The QRC concerns with the Short Run Variable Maintenance Cost adjustment factor (3.1(b)(iii)) have not been addressed. The factor operates in a way which suggests that maintenance costs are variable with forecast volumes, but exhibit no variability whatsoever with actual volumes.
- The adjustment in 3.3(b)(vii) effectively makes AT1 revenue part of the revenue cap, as any shortfall will be recovered in a later year. AT1 should reflect variable costs and should therefore remain a variable revenue item.
- Aurizon Network should not be in a position to claim an Increment (Clause 3.4) until a balanced package of incentive mechanisms is introduced into the Undertaking. Clause 3.4 of Schedule F should be replaced by a commitment to develop and submit for approval, a draft incentive mechanism based on the requirements of Clause 2.6 of UT3.
- In Clause 3.3(c)(ii), Aurizon Network's TOP revenue is calculated on the basis that Aurizon Network is deemed to have contracted on the terms of the relevant Standard Access Agreement. This ensures that Aurizon Network cannot negotiate an amendment to an Access Agreement which reduces the Access Holder's TOP exposures, then recover the lost revenue through the revenue cap. However, the addition of the words "*except for those Access Agreements which have been altered from the relevant Standard Access Agreement in accordance with any Approved Undertaking*" may defeat the intent of the introductory words. Any amendment to an Access Agreement which is agreed between the parties is arguably "in accordance with an Approved Undertaking", as all undertakings allow non-standard terms to be agreed between parties. However, such an agreement between parties in regard to TOP conditions should not result in the transfer of costs to other parties.

## 4 Socialisation of WIRP

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Our understanding of Aurizon Network's approach to WIRP under the 2014 DAU can be summarised as follows:

- a forecast tonnage equal to 90% of contract is adopted for WIRP. Aurizon Network has stated that this is not intended to be a realistic forecast. The forecasts provided in the QCA's draft MAR decision appear to support this view; and
- due to the high WIRP volume forecast which is used for deriving the Blackwater tariffs, the tariffs are substantially lower than they would be in a 'without WIRP' scenario (that is, the addition of WIRP at these forecast volumes, when socialised, reduces average tariffs).

The QRC's concerns regarding the impact which this approach has on the TOP exposures of existing users of the Blackwater system, and the proposal of Aurizon Network to selectively shield UT1 agreements from this impact, were discussed in Part 2 of this Schedule F submission.

The QRC does not have a view at this stage as to how the impacts on TOP exposures should be addressed, or on how WIRP should be priced or incorporated into Blackwater prices. In addition, the QRC does not have a view on the likely levels of utilisation of the WIRP infrastructure, or on whether Blackwater tariffs would be higher or lower on a 'without WIRP' scenario on the basis of such levels of utilisation. Further transparency in the form of a simplified model showing revenue requirements and tonnages in the

Blackwater system with, and without WIRP, may assist stakeholders in considering this issue.

## Glossary of terms

Term	Meaning
<b>2013 DAU</b>	Aurizon Network's 2013 Draft Access Undertaking
<b>2014 DAU</b>	Aurizon Network's 2014 Draft Access Undertaking.
<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</i> (Qld)
<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

Term	Meaning
<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>STT</b>	Short Term Transfer
<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>	access undertaking 4
<b>WACC</b>	Weighted Average Cost of Capital
<b>WICET</b>	Wiggins Island Coal Export Terminal



## Appendix 1

### Key items – QRC response to Aurizon Network redraft July 2014 – Access Holder Access Agreement

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The table below identifies the reasoning for particular key aspects of the QRC response to the Aurizon Network 2014 redraft of the Access Holder Access Agreement (AHAA). The table does not seek to limit the QRC's mark-up to the Aurizon Network 2014 redraft of the AHAA.

No	Issue	Clause	Reasoning for QRC response to Aurizon Network redraft 2014 - Access Holder Access Agreement
1	Consequential Loss	1.1	<p>The QRC does not agree with Aurizon Network's position and maintains that the corresponding definition in the UT3 SAAs is not to be preferred. There is no settled meaning at law of 'special', 'indirect', 'consequential' or 'special' loss. Please refer to the associated Journal of Contract Law article 'Exclusion of Liability for Consequential Loss' by JW Carter in support of this at Appendix 2.</p>
2	Operation of Ad Hoc Train Services	3.3(b)	<p>The QRC does not consider that the process for rescheduling a train service (including Ad Hoc Train Services) is adequately provided for in the Network Management Principles (despite Aurizon Network's position).</p> <p>The QRC has previously raised concerns as to why Aurizon Network is not obliged to make the infrastructure available and to use reasonable endeavours to reschedule contracted Train Services for Ad Hoc Train Services – the QRC continues to hold these concerns.</p> <p>The QRC cannot accept Aurizon Network's exclusion of liability.</p>
3	Security	6	<p>The QRC maintains that the Access Holder ceasing to have an Acceptable Credit Rating should merely be a factor Aurizon Network can consider when determining if an Access Holder is required to provide Security rather than an arbitrary trigger for the provision of Security.</p> <p>The QRC cannot accept the inclusion of this arbitrary trigger.</p>
4	Commencement of Train Services	7.2	<p>The QRC considers that Aurizon Network should be required to give the notice under clause 7.2(c)(ii) in accordance with that clause to ensure that Aurizon Network complies with the specific requirements</p>



associated with the giving of that notice.

As termination is a consequence of the End User failing to comply with clause 7.2(a) after receiving a notice from Aurizon Network, the QRC maintains that it is appropriate for Aurizon Network to provide *written* notice to the End User to effect a termination of the Agreement.

5	Supply Chain Rights	7.4	<p>The QRC considers that as amended by Aurizon Network, the Supply Chain Rights provisions are still overly prescriptive and onerous, potentially placing the End User in an untenable position.</p> <p>The QRC maintains that to achieve a commercially viable position, the End User should have the ability to demonstrate that it holds or has a reasonable likelihood of <i>obtaining</i> the Supply Chain Rights, as opposed to being required to use reasonable endeavours to hold or have the benefit of the Supply Chain Rights.</p> <p>The QRC maintains that the AHAA should not be amended where the End User removes a nominated Operator but there is an additional existing Operator appointed for that Train Service Type.</p>
6	Use of Regenerative Brakes and Power	7.5	<p>The QRC would like to better understand the necessity for this provision.</p>
7	Resumption Notice	8.4	<p>The QRC considers that the Resumed Access Rights for the relevant Train Service Type which cease to form Access Rights should not be used for the purpose of calculating TOP Charges, as clause 8.4 contemplates Aurizon Network having a reasonable expectation of a sustained alternative demand for, or, receiving a commercial benefit in relation to the Resumed Access Rights.</p>
8	Dispute	8.5	<p>The QRC has again amended the time period for notice of a dispute to 20 Business Days as the QRC does not consider that 10 Business Days is sufficient time to consider whether to dispute a resumption of Access Rights.</p>
9	Reduction of Conditional Access Rights due to Capacity Shortfall	9	<p>The QRC maintains that the time to determine whether a Capacity Shortfall exists must be no longer than 6 months.</p> <p>The QRC maintains that in circumstances where the Conditional Access Rights are reduced due to a Capacity Shortfall caused by an act or omission of Aurizon Network, Aurizon Network will be deemed to be in breach of the agreement. Conditional Access Rights should not be reduced where the Capacity Shortfall is</p>



caused by an act or omission of Aurizon Network.

Accordingly, the QRC considers that Aurizon Network should be required to identify and include in the Capacity Assessment Notice, the reason for the Capacity Shortfall and that disputes should be able to be raised in relation to the reasons for the Capacity Shortfall.

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10	Relinquishment of Access Rights	13	<p>The QRC maintains that for efficiency purposes, Aurizon Network should be obliged 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 to not unreasonably delay the negotiation (and execution) of that Access Agreement.</p> <p>The QRC maintains that Aurizon Network should be required to provide written reasons for assumptions made in relation to determining the Relinquishment Fee rather than merely having to notify the End User of the assumptions Aurizon Network made.</p> <p>The QRC does not consider that an Expert should be required to make reasonable assumptions that Aurizon Network was entitled to make in calculating the Relinquishment Fee. If the Expert were to be required to make the same assumptions Aurizon Network was entitled to make, the intrinsic impartiality associated with the Expert may be undermined.</p>
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11	Reduction Factor	15	<p>The QRC maintains that Aurizon Network’s assumptions in respect of the Reduction Factor must be reasonable.</p> <p>For clarity, the QRC has amended clause 13.3(e) to provide that the End User may dispute any component of the Relinquishment Fee (such as the Reduction Factor).</p>
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12	Train Control rights and obligations – Aurizon Network	17.2	<p>The QRC maintains that Aurizon Network should be obliged to act in good faith in the situations listed in clause 17.2(b).</p>
<hr/>			
13	Removal at the end of Authorised Parking	17.5	<p>The QRC considers that 24 rather than 12 hours is a more appropriate time period to mobilise the removal of a Train or Rollingstock where Aurizon Network has not otherwise specified the expiry of a permitted period. Further, this time period should run from the point at which the End User receives written notice from Aurizon Network requiring the removal of the Train or Rollingstock.</p> <p>The QRC has subjected Aurizon Network’s ability to take action to remove a Train or Rollingstock to an obligation for Aurizon Network to first use reasonable efforts to negotiate the removal of the Train or Rollingstock within</p>

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a further 2 hour period.

The action Aurizon Network may take to remove the Train or Rollingstock should be reasonable.

The End User should be required to pay the reasonable costs incurred in Aurizon Network removing the Train or Rollingstock within 10 Business Days of receiving a demand for consistency with other payment provisions.

14	Compliance – Non-compliance by the End User and / or Operator with Train Service Description	18.2	The QRC maintains changes to the Access Rates should only compensate Aurizon Network for reasonable increases in costs or risk or for direct increases in utilisation of the Capacity.
15	Compliance with Aurizon Network’s Accreditation	18.6	The QRC maintains that Aurizon Network should not avoid liability for breaching the agreement where the breach is caused by its own negligence or a breach of the Accreditation.  The QRC maintains that 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 maintains it is reasonable for this obligation to be limited to the extent the terms and conditions have been notified to the End User.
16	Approval of amendments to Operating Plan	19.2(d)	Where the Operating Plan ceases to be consistent as required, the QRC considers Aurizon Network should be required to notify the End User of this inconsistency in addition to notifying the Operator, as the End User is required to cause the Operator to amend the Operating Plan to address the inconsistency.
17	Alterations to Train Services by Operator / Aurizon Network	20.2 and 20.3	The QRC does not agree that the process for rescheduling a train service is adequately provided for in the Network Management Principles. Accordingly, the QRC has reinstated the provisions reflected in the QRC’s previous mark-up.
18	Notification	20.5	The QRC does not accept that Aurizon Network is unable to notify multiple End Users / Operators at the same time when Aurizon Network becomes aware of the occurrence of a relevant event. The QRC considers this should be within the capabilities of Aurizon Network.
19	Variation to Access Charge	21.12	The QRC maintains that variations should only be made as a result of reasonable and proper increases to costs.



	Rates		<p>The QRC does not consider that variations should be made as a result of an increase to risk. The QRC maintains an increased utilisation of the Capacity should not be a basis for varying the Access Charge Rates.</p> <p>For transparency, the QRC maintains that Aurizon Network must provide the End User with information reasonably required to verify a cost claimed under this clause.</p>
20	Amendments to System Wide Requirements	22	<p>The QRC maintains the position outlined in the most recent response mark up. The QRC places particular importance on Aurizon Network being required to:</p> <ul style="list-style-type: none"><li>• notify the End User of any Discretionary System Amendment irrespective of whether it will fundamentally frustrate the Operator's operations of Train Services over a sustained period; and</li><li>• fund the costs of the parties where an amendment is required due to conduct attributable to Aurizon Network.</li></ul>
21	Review of Performance Levels	24.3	<p>The QRC maintains it is appropriate that the Parties be permitted to refer disputes regarding variations to Performance Levels to an Expert for determination.</p>
22	Maintenance of the Nominated Network	25.2	<p>The QRC acknowledges that Aurizon Network is obliged to maintain the Network so that it is suitable for operation and is therefore well placed to determine what Operational Constraints are necessary, however considers that Aurizon Network should be held to a reasonable standard when imposing Operational Constraints given the potential impacts on Access Holders.</p>
23	Incident management – management of incident response	26.6	<p>The QRC considers the new indemnity given by the End User in favour of Aurizon Network to be unreasonable and has deleted this accordingly.</p>
24	Incident management – management of Environmental Incidents	26.8	<p>The QRC considers that Aurizon Network should be required to provide a complete copy or details (as applicable) of the direction, notice or order given by the Environmental Regulator considering the End User is responsible for implementing the actions required by the Environmental Regulator.</p>
25	Qualifications of End User's Staff	28.2	<p>The QRC maintains the scope of Required Information incorporated by Aurizon Network is too broad. The QRC considers the provision of details should be limited to position titles and if reasonably required, the names of</p>



the End User's Staff engaged in Safety Related Work.

The QRC maintains that Safety Related Work may be performed by any of the End User's Staff who satisfy the requirements of clause 28.2.

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26	Interface representative	29.8	The QRC maintains that the requirement for an interface representative should be mutual. The QRC has also incorporated a reciprocal right for the End User to, acting reasonably, cause Aurizon Network to nominate a different representative of Aurizon Network where the End User is not satisfied with the performance of an Aurizon Network Interface Representative.
27	Disclosure of insurance policies	31.3	The QRC maintains that the End User has no obligation to ensure that the Operator provides evidence of its insurance policies to Aurizon Network.
28	Determination of liability and loss adjustment	34	<p>The QRC notes Aurizon Network's response on the claim threshold, however the QRC maintains that the claim threshold should be reduced to \$100,000 for consistency with clause 33.2. Accordingly, for consistency the maximum claim amount where the loss adjuster's decision is final has been reduced to \$100,000.</p> <p>The QRC maintains the 5 year period proposed by Aurizon Network with respect to the loss adjuster's former employment is unacceptable and that 8 years is a more appropriate timeframe.</p>
29	Intellectual property and permitted use of Confidential Information	43	The QRC is opposed to the new obligation incorporated by Aurizon Network which provides that the End User grants, and must ensure the Operator grants, a broad licence to Aurizon Network allowing Aurizon Network to use, modify and reproduce the Confidential Information for particular purposes. Accordingly, the QRC has deleted this obligation.
30	Suspension Event / Termination Events	Schedule 9	The QRC maintains its previous position in relation to the suspension and termination events listed in Schedule 9 and cannot accept Aurizon Network's position.

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JW Carter article

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## Exclusion of Liability for Consequential Loss

*J W Carter\**

### Introduction

In *Holt & Co v Collyer*<sup>1</sup> Fry J was required to construe the word 'beerhouse' in a lease. It was, he said:<sup>2</sup>

important to the public that the meaning of the word 'beerhouse' should be ascertained once for all, because then persons who have to draw instruments relating to businesses of this sort will know on what principle to proceed, and counsel who are called upon to advise whether there is or is not a case to proceed upon at law will know how to advise.

The passage illustrates a belief that words have 'absolute and constant referents'.<sup>3</sup> It is seldom ventilated today. If the modern cases on the interpretation of contracts stand for anything, it is that the meaning of the words in a contractual document vary according to the context in which they are used. Yet, the cases interpreting the expression 'consequential loss' in exclusion clauses come close to emulating the non sequitur of Fry J.

There are two schools of thought on the meaning of 'consequential loss' in an exclusion clause. The English cases suggest that 'consequential loss' means loss which might (but for the exclusion) be recoverable under the second limb of the rule in *Hadley v Baxendale*.<sup>4</sup> Under that approach, the exclusion is not applicable to any loss recoverable under the first limb of the rule.<sup>5</sup> Since the modern root of this view is *Croudace Construction Ltd v Cawoods Concrete Products Ltd*,<sup>6</sup> it is appropriately described as the 'Croudace view'.

Second, the decision of the Court of Appeal of Victoria in *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd*<sup>7</sup> asserts that 'consequential loss' refers to any loss which is not a 'normal loss'. Since, in reaching this

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\* Professor of Commercial Law, University of Sydney; General Editor, *Journal of Contract Law*; Consultant, Freehills. I gratefully acknowledge the helpful suggestions of an anonymous referee.

1 (1881) 16 Ch D 718.

2 (1881) 16 Ch D 718 at 722. Cf *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 35 NSWLR 227 at 236 (conception that some words have 'fixed' meanings).

3 *Pacific Gas and Electric Co v G W Thomas Drayage & Rigging Co Inc*, 69 Cal 2d 33 at 38; 442 P 2d 641 at 644; 69 Cal Rptr 561 at 564 (Cal, 1968) per Traynor CJ. See also Glanville Williams, 'Language and the Law — IV' (1945) 61 *LQR* 384.

4 (1854) 9 Ex 341 at 354; 156 ER 145 at 151 (damages that 'may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it').

5 That is, damages that 'may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself'.

6 [1978] 2 Lloyd's Rep 55. (Hereafter '*Croudace*'.)

7 [2008] VSCA 26. (Hereafter '*Environmental Systems*'.)



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conclusion, the court relied on *McGregor on Damages*,<sup>8</sup> this may be termed the 'McGregor view'.

When stated as an abstract proposition, neither view is correct. But for the cases supporting the two opposing views, 'consequential loss' could not be regarded as some sort of legal term of art attracting a presumption in favour of a particular (legal) meaning. Nor should that presumptive approach be accepted. The issue is a very important one. An exclusion of liability for 'consequential loss' is very common in modern contracts, especially in contracts for the supply of goods.<sup>9</sup> The meaning of the expression must depend on the intention of the parties and can only be determined in reference to the contract in which the expression is used, read as a whole and considered in light of admissible background material. That is the view developed below.

### Elements of Exclusion Clauses

It is, of course, difficult to say anything new about exclusion clauses.<sup>10</sup> Given the thousands of cases which have come before the courts over the years it is hard to imagine a more well-trodden area of contract law. Nevertheless, it is useful to start with some basic points.

An exclusion clause the objective of which is to deal with a potential liability in damages, assumes three things:

- (1) a basis for liability, that is, a breach of duty — usually a breach of contract or tort;
- (2) an act or omission which satisfies the legal requirements of the basis for liability; and
- (3) that the promisee has sustained loss or damage as a result of the act or omission.

Of course, the extent to which a particular exclusion clause deals with such matters varies considerably. There is, after all, an infinite variety of circumstances to which exclusion clauses may apply. Sometimes, the words used are very meagre indeed. Consider, for example, a clause which says 'A is not liable to B for breach of this agreement'. As a matter of language, such a clause presents no interpretation difficulties at all. The meaning is abundantly clear at the linguistic level. Nevertheless, it is important not to confuse the linguistic meaning of the clause with the scope of its application. First, take the word 'breach'. That associates the clause with a particular basis of liability, namely, breach of contract. However, the act or omission amounting to a breach of contract may also sound in tort. The mere fact that the clause associates itself with breach of contract does not mean that the clause is necessarily inapplicable to a liability in tort which also arises from the same breach of duty. Equally, however, the clause does not address the issue.

Second, the 'act or omission' amounting to a breach of contract may involve

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<sup>8</sup> See H McGregor, *McGregor on Damages*, 17th ed, Sweet & Maxwell, London, 2003, §§1-036, 1-037-1-039.

<sup>9</sup> It is also a common qualification to liability on a promise of indemnity. However, I do not deal with the cases on such provisions.

<sup>10</sup> I use the expression 'exclusion clause' to include a provision which expressly excludes, qualifies or limits liability.



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non-performance, late performance or defective performance. The association with the basis for liability may arise because the promisor has failed to discharge a strict duty or a duty of care. Even if the duty is strict, the act or omission may involve a failure to exercise care. And, whatever the nature of the duty, the act or omission may have been wilful. Again, an exclusion in the form 'A is not liable to B for breach of this agreement' does not in terms deal with these issues.

Third, although an exclusion clause the object of which is to deal with damages liability, necessarily assumes that the relevant breach of duty gives rise to loss or damage — since otherwise there is nothing on which the exclusion could bite — the loss or damage which the promisee suffers is variable. It may be purely financial loss, include property damage or personal injury. And in some cases non-pecuniary loss may be suffered. Whatever the loss or damage, the breach of duty may be the sole or merely a contributing cause. Loss may be suffered immediately, or depend on subsequent events. The loss or damage may be serious or minor. From the perspective of the rule in *Hadley v Baxendale* the loss or damage may fall within the first limb, the second limb or neither limb. However, an exclusion drafted in terms 'A is not liable to B for breach of this agreement' does not actually engage with any of these issues.

If an exclusion of liability for 'consequential loss' is at issue, the primary focus is on the third aspect, that is, 'loss or damage'. The use of the word 'consequential' would seem to assume that the promisor is accepting liability for some loss or damage, namely, loss or damage which is not consequential. However, the clause approaches the issue from a conceptual perspective. The clause assumes, but does not explain, the content and scope of an underlying concept. Of course, the other elements noted above must also be satisfied, so that the loss must arise by reason of a breach of duty within the scope of the clause, and the act or omission must also be within its scope.

## The Opposing Views

### The Croudace View

In *Croudace*, cl 4 of a contract for the supply of goods said:

... We are not under any circumstances to be liable for any consequential loss or damage caused or arising by reason of late supply or any fault failure or defect in any material or goods supplied by us or by reason of the same not being of the quality or specification ordered or by any other matter whatsoever.

The sellers were late in delivering the goods and the buyers' claim for damages included an indemnity against a claim by subcontractors to whom the buyers supplied the goods. The issue was whether the loss under that claim was 'consequential loss or damage' within the meaning of cl 4.

At first instance, Parker J held that it was not. He construed the clause as applicable only to loss or damage recoverable under the second limb of the



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rule in *Hadley v Baxendale*. This was, he said,<sup>11</sup> the 'natural meaning of the words'. Parker J concluded:<sup>12</sup>

It may be that this does not give the [sellers] the protection which they would like, but the clause has, so construed, a sensible workable and valuable meaning which appears to me to accord with commercial sense . . .

The decision was affirmed by the English Court of Appeal. Indeed, the court considered the better view to be that it was bound by a prior decision<sup>13</sup> to interpret the clause as Parker J had done.

The *Croudace* view has been consistently applied in a great many English cases.<sup>14</sup> It was also applied in at least one Australian case.<sup>15</sup>

### The McGregor View

The *Environmental Systems* decision concerned the supply of a REECO Regenerative Thermal Oxidiser ('RTO') to Peerless at a price of \$675,000. Peerless conducted an animal rendering plant. A term of its licence from the Environment Protection Authority required odour emissions from the plant to be dealt with satisfactorily. The RTO was acquired to replace an existing afterburner which was used to incinerate gaseous emissions and destroy odour. However, when it was installed the RTO did not perform as expected. Odour emissions while it was in operation were not adequately dealt with, and after abortive attempts to make the RTO perform to its satisfaction Peerless was forced to reinstate the afterburner. The RTO was then scrapped.

Peerless claimed damages from Environmental. The claim was presented in terms of four heads of loss:

- (1) the cost of purchasing, installing and commissioning the RTO, attempting to make the RTO functional and repairing the existing afterburner (\$1,275,520);
- (2) the labour costs involved in attempting to make the RTO functional (\$223,560);
- (3) the cost of dismantling and disposing of the RTO (\$34,000); and
- (4) additional energy costs incurred as a consequence of the RTO not being functional (\$1,448,881 or \$1,712,419).

For its part, Environmental relied on cl 8.9 of the contract, an oddly worded provision which stated:

#### 8.9 LIQUIDATED DAMAGES AND/OR CONSEQUENTIAL LOSS

As a matter of policy, Environmental Systems does not accept liquidated damages or consequential loss. Environmental Systems is motivated to achieving agreed

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11 [1978] 2 Lloyd's Rep 55 at 59.

12 [1978] 2 Lloyd's Rep 55 at 59.

13 *Millar's Machinery Co Ltd v Way* (1934) 40 Com Cas 204.

14 See *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 42; *Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd's Rep 387 at 403; *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 at 598 (affirmed without reference to the point [2000] 2 Lloyd's Rep 277); *Pegler Ltd v Wang (UK) Ltd* [2000] BLR 218; 70 Con LR 68; *Addax Ltd v Arcadia Petroleum Ltd* [2000] 1 Lloyd's Rep 493 at 496; *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] 1 All ER (Comm) 750; [2000] EWCA Civ 74.

15 *Frank Davies Pty Ltd v Container Haulage Group Pty Ltd* (1989) 98 FLR 289 at 313.



milestones through respect for the client's needs and the obvious financial advantage gained from completion of projects in the shortest possible period.

It was held that the failure of the RTO was attributable to one or more breaches of contract by Environmental relating to the quality of the RTO or its functional capacity to destroy odour. Clause 8.9 was construed as an exclusion of liability for consequential loss. Relevantly, therefore, the issues were whether Peerless was entitled to recover in respect of the losses and the extent to which cl 8.9 protected Environmental.<sup>16</sup>

The trial judge (Hansen J)<sup>17</sup> applied the *Croudace* view and therefore held<sup>18</sup> that 'consequential loss' in cl 8.9 meant a loss within the second limb of the rule in *Hadley v Baxendale*. However, Nettle JA (with whom Ashley and Dodds-Streton JJA agreed) thought otherwise. Adopting the *McGregor* view, Nettle JA said<sup>19</sup> that the 'true distinction is between "normal loss", which is loss that every plaintiff in a like situation will suffer, and "consequential losses", which are anything beyond the normal measure'. After reviewing the authorities, Nettle JA concluded:<sup>20</sup>

In my view, ordinary reasonable business persons would naturally conceive of 'consequential loss' in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach. Despite the construction which has been put on 'consequential losses' by cases such as [*Millar's Machinery Co Ltd v Way* (1934) 40 Com Cas 204] and *Croudace*, it would be unrealistic to suppose that the appellant and the respondent employed the expression 'consequential loss' in cl 8.9 of the agreement advisedly in that sense. It is more likely in this context that they intended the expression to have its ordinary and natural meaning. Accordingly, I would construe the expression 'consequential loss' in cl 8.9 as intended to have that meaning. Read in the light of the contract as a whole, and giving due weight to the context in which the clause appears, including the nature and object of the contract, I see no ambiguity which as a matter of principle would warrant a departure from that view. It follows as I see it that, although the judge's approach in this case was in accordance with the English cases, it was not correct to construe 'consequential loss' as limited to the second rule in *Hadley v Baxendale*.

Nettle JA proceeded to consider each head of loss. He held that Peerless succeeded on the first head, namely, the cost of purchasing, installing and commissioning the RTO, attempting to make the RTO functional and repairing the existing afterburner. This was not a 'consequential loss'. The third head — the cost of dismantling and disposing of the RTO — had been rejected by Hansen J on the basis that those costs would have been incurred in any event.

<sup>16</sup> There was also a claim for damages for contravention of s 52 of the Trade Practices Act 1974 (Cth).

<sup>17</sup> Sub nom *Peerless Holdings Pty Ltd v Environmental Systems Pty Ltd* [2006] VSC 194.

<sup>18</sup> Hansen J also took the view that, in part, Peerless' claim was for 'liquidated damages'. The Court of Appeal disagreed with that view.

<sup>19</sup> [2008] VSCA 26 at [87]. The quotation is based on H McGregor, *McGregor on Damages*, 17th ed, Sweet & Maxwell, London, 2003, §1-036.

<sup>20</sup> [2008] VSCA 26 at [93]. The first part of the statement is effectively a quotation from H McGregor, *McGregor on Damages*, 17th ed, Sweet & Maxwell, London, 2003, §1-036.



No adverse comment was made in relation to that.<sup>21</sup> However, the Court of Appeal held that the other two heads of loss fell within the concept of consequential loss and were therefore excluded by cl 8.9.<sup>22</sup>

## Discussion

### The Problem

As indicated at the beginning of this article, the problem with the opposing views is that each adopts a technical — term of art — approach to the meaning of ‘consequential loss’. On that basis, so far as English courts below the House of Lords are concerned, a presumed meaning (the *Croudace* view) applies to any contract in which the expression is found.<sup>23</sup> Similarly, in Australia, the *McGregor* view is presumptively applicable to any contract considered by a court other than the High Court of Australia. Although this does not prevent the presumption being rebutted by reference to the construction of a particular contract, just how Australian courts will apply the *McGregor* view remains to be seen. However, the English courts have, on the whole, shown no willingness to find the presumption to be rebutted on the basis of the construction of a particular contract.<sup>24</sup>

What is striking about the opposing views is their interaction with how the courts explain the application of damages principles. That may be considered from a general perspective (the approach to contract damages) and also the more specific perspectives of the recovery of loss of profit and an apparent ‘black hole’ in the *McGregor* view. But discussion should begin with an even more striking feature of the opposing views, namely, that each has been justified on the basis of ‘natural meaning’.

### Natural Meaning

Commercial parties might be expected to use an expression such as consequential loss in a commercial rather than a legal sense. On that basis it seems right to start with the ‘natural meaning’ of the expression. That is the starting point of both the opposing views. However, each comes to a different conclusion. Both the opposing views are, ultimately, ‘English’ views. And in other contexts, English courts have fastened on a third ‘natural meaning’ for ‘consequential loss’.<sup>25</sup> It might be asked, rhetorically, ‘If courts cannot agree on “natural meaning” how can that be a reliable guide?’

21 But see [2008] VSCA 26 at [125] (‘costs of its demolition and removal’ recoverable for contravention of s 52 of the Trade Practices Act 1974 (Cth)).

22 The victory of *Environmental* was somewhat pyrrhic as the claim for damages for contravention of s 52 of the Trade Practices Act 1974 (Cth) was successful and not affected by cl 8.9.

23 Although this was perhaps doubted by the English Court of Appeal in *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] 1 All ER (Comm) 750; [2000] EWCA Civ 74 at [20], approaching the matter as a question of principle it nevertheless agreed that an exclusion of consequential loss requires the court to classify loss by reference to the rule in *Hadley v Baxendale*.

24 Contrast *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd’s Rep 583 at 600 (affirmed without reference to the point [2000] 2 Lloyd’s Rep 277).

25 See eg *Mediterranean Freight Services Ltd v BP Oil International Ltd (The Fiona)* [1994] 2 Lloyd’s Rep 506 at 522 per Hoffmann LJ, with whom Nourse LJ agreed (natural reference



In fact, the reason why the opposing views attribute different 'natural' meanings is that they are really two different legal meanings. Parker J's recourse to the concept in *Croudace*, and his suggestion that the decision was in 'accord with commercial sense and probably commercial intention', suggest that commercial people not only understand the rule in *Hadley v Baxendale* but also associate the two limbs with a contrast between direct and consequential loss. Similarly, in *Environmental Systems*, the court thought it 'more likely . . . that [the parties] intended the expression to have its ordinary and natural meaning'. But since that meaning could only be available to parties familiar with the terminology of *McGregor on Damages* (or the authorities on which it is based), that also attributes to commercial parties a much greater knowledge of the law than can reasonably be expected.

Reliance on 'natural' meaning is, of course, in accordance with the general approach which is nowadays put forward as the basis for interpreting of exclusion clauses. For example, in *Darlington Futures Ltd v Delco Australia Pty Ltd*<sup>26</sup> the High Court of Australia said:

[T]he interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause *contra proferentem* in case of ambiguity.

Similarly, in *Allsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd*,<sup>27</sup> Lord Wilberforce said: 'The relevant words must be given, if possible, their natural, plain meaning'.

There is, however, a difference between 'natural meaning' from the perspective of the linguistic meaning of an exclusion clause and 'natural meaning' from the perspective of its scope of application. The 'meaning' of consequential loss must depend on the parties' intention in relation to the scope of the words. Clearly, that is not a question which can be determined in the abstract. The natural meaning of a clause which states 'A is not liable to B for any consequential loss suffered by B as a result of A's breach of this agreement' is not in doubt from a linguistic perspective. All the words can be understood and all have 'natural' meanings. The natural meaning of 'breach of this agreement' is 'failure to discharge a contractual duty', and the natural meaning of 'consequential loss' is 'loss which is not a direct loss'. Ultimately, however, the issue is not one of meaning at all. Because the issue is the scope of application of the clause, the only guidance which the (linguistic) 'natural' meaning provides is to determine whether the clause is *capable* of applying to the events which have occurred.

The first two meanings of 'consequential' listed in the *Oxford English Dictionary*<sup>28</sup> are 'Of the nature of a consequence or sequel' and 'Of the nature

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of 'direct' and 'indirect' is to causation and construction of 'directly or indirectly' in Hague-Visby Rules did not invoke rule in *Hadley v Baxendale*).

<sup>26</sup> (1986) 161 CLR 500 at 510; 68 ALR 385.

<sup>27</sup> [1983] 1 WLR 964 at 966; [1983] 1 All ER 101 at 102.

<sup>28</sup> 2nd ed, OUP, Oxford, 1989. The entry from the first edition is referred to in *Saint Line Ltd v Richardson Westgarth & Co Ltd* [1940] 2 KB 99 at 103, which is in turn quoted by Parker J in *Croudace* [1978] 2 Lloyd's Rep 55 at 59.



of a consequence merely, not direct or immediate'. The word 'following' is listed as a synonym for the first; and the second is followed by a definition of 'consequential damages', namely, 'losses or injuries which follow an act, but are not direct and immediate upon it'.<sup>29</sup> For those who believe that the 'natural' (dictionary) meaning should be used to interpret exclusion clauses, neither under the *Croudace* view nor under the *McGregor* view is either of these meanings actually adopted. Importantly, neither view comes to terms with the fact that 'consequential' may mean 'not direct and immediate'.

It is easy to understand that a court required to interpret the expression 'consequential loss' in an exclusion of liability would normally reject the view that 'consequential' means 'following' or 'caused by'.<sup>30</sup> What is not so easy to understand is why a court — adopting the *Croudace* view — would also reject the meaning of 'not direct or immediate' and leap to the conclusion that the word 'consequential' must be understood by reference to the rule in *Hadley v Baxendale*. The same comments may be made, albeit from a slightly different perspective, of the *McGregor* view. The dictionary meanings relate to causation. But the perspective of normal loss — as contrasted with the *McGregor* view of consequential loss — is measure of damage, not causation. Why this was seen in *Environmental Systems* as more 'realistic', and why the court regarded this meaning as giving effect to the 'ordinary and natural' meaning of the expression, is difficult to fathom.

### Approach to Contract Damages

Even at the general level of the courts' approach to contract damages, several issues arise in relation to both the opposing views. The first is the extent to which either view mirrors the application of damages principles.

One would indeed expect to find support for the *Croudace* view in the cases applying the rule in *Hadley v Baxendale*. Indeed, *McGregor's* objection to the *Croudace* view is that it adopts a meaning for consequential loss which is contrary to the understanding of the term in the context of claims for damages. However, none of the modern cases interpreting *Hadley v Baxendale* have sought to explain the contrast between the two limbs by reference to whether or not a particular loss is consequential.<sup>31</sup> That exposes a point of discontinuity between the *Croudace* view and the cases applying Baron Alderson's rule. The rule is concerned with remoteness.<sup>32</sup> In the modern law, the rule grades losses according to the contemplation of the parties, not their

<sup>29</sup> The definition is a quote attributed to 'Wharton'.

<sup>30</sup> See *Saint Line Ltd v Richardsons Westgarth & Co Ltd* [1940] 2 KB 99 at 103 per Atkinson J: 'The word "consequential" is not very illuminating, as all damage is in a sense consequential'. However, it is, of course, quite possible that the purpose of a particular exclusion clause is to exclude liability for all loss or damage.

<sup>31</sup> See eg *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518 at 534 per Lord Clyde ('loss . . . may well not include all the loss which the breach of contract has caused. It may not be able to embrace consequential losses, or losses falling within the second head of *Hadley v Baxendale*').

<sup>32</sup> However, it might be noted that in the sale of goods legislation the statements of the first limb of the rule are expressed in terms of the loss 'directly and naturally resulting'. See *Joseph & Co Pty Ltd v Harvest Grain Co Pty Ltd* (1996) 39 NSWLR 722 at 728, 735.



directness.<sup>33</sup> The distinction between the two limbs does not rely on remoteness of cause. In contrast, causation is a 'yes or no' concept, and both in law and ordinary speech the word 'consequential' is used in opposition to 'direct'. Therefore, not only does the *Croudace* view attribute to commercial people an understanding of the details of contract law, it also attributes to them a view of the law which is at odds with the cases on contract damages. It is strange to interpret 'consequential loss' as a legal term of art by attributing to contracting parties a usage which is virtually unknown in the modern law of damages.

Second, each view calls into question the utility of the exclusion. Under the *Croudace* view, an exclusion of liability for consequential loss will generally have no impact on the promisor's claim for damages. It does seem somewhat counter-intuitive for the parties to go to the trouble of excluding a type of loss which is not likely to be in issue. An exclusion of liability for consequential loss must be of doubtful utility if it applies only to second limb damages because such damages are rarely at issue.<sup>34</sup> But the *McGregor* view is also questionable from a utility perspective. In a great many cases — particularly where damages are claimed following the breach of a contract for the sale of goods — the promisor will be limited to recovery under a conventional measure of loss. On that basis, the *McGregor* view seems open to the same criticism as the *Croudace* view, namely, that an exclusion of consequential loss relates to a measure of loss which is generally not applicable.

Third, there is no reason to expect that parties are only concerned to exclude recoverable losses. *McGregor* says<sup>35</sup> it is 'contradictory' for a promisee to communicate a (second limb) loss and then agree to its exclusion. However, there are several answers to the point.<sup>36</sup> If a loss which would be recoverable under the second limb has been communicated prior to entry into the contract the basis for holding the promisor-defendant liable is that 'the defendant's conduct in entering into the contract without disclaiming liability for the enhanced loss which he can foresee gives rise to the implication that he undertakes to bear it'.<sup>37</sup> Since the possibility of the loss has been communicated, the promisor may not be willing to enter into the contract unless the promisee agrees to the exclusion. Moreover, where a contract is drafted by a lawyer who is ignorant of the actual communications between the parties the exclusion may be inserted to protect the client against the possibility that those communications included information from which a court would draw the inference that the promisor accepted responsibility. In any event, an exclusion of consequential loss is commonly found in a supplier's standard terms of business which are necessarily drafted

33 See *Bence Graphics International Ltd v Fasson UK Ltd* [1998] QB 87 at 93 per Otton LJ (with whom Auld LJ generally agreed) (courts now place more emphasis on 'reasonable contemplation' than the question of 'directness').

34 Cf *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 at 599–600 (affirmed without reference to the point [2000] 2 Lloyd's Rep 277).

35 H McGregor, *McGregor on Damages*, 17th ed, Sweet & Maxwell, London, 2003, §1-038. The argument influenced the Court of Appeal in *Environmental Systems* (see [2008] VSCA 26 at [90]).

36 See also *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] 1 All ER (Comm) 750; [2000] EWCA Civ 74 at [10].

37 *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428 at 1448 per Diplock LJ.



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independently of the actual communications which may occur under specific contracts. Therefore, it is far from surprising that a supplier would want to deal with the possibility that communications relevant to the second limb have occurred or may have occurred.

What is wrong with the *Croudace* view is that the expression 'consequential loss' should be associated with either limb, rather than consequential loss in general. There is no doubt that the *McGregor* view is a closer approximation to the courts' approach to measure of damages than the *Croudace* view is an approximation of the approach to remoteness.<sup>38</sup> The problem, however, is that, as a commercial concept, 'consequential loss' is no more concerned with measure of damage (the *McGregor* view) than remoteness of loss (the *Croudace* view).

### Application of the McGregor view in Environmental Systems

It will be recalled that in *Environmental Systems* the claim by Peerless under the first head was not regarded as falling within the exclusion of liability for consequential loss. The first head comprised three categories or components of loss:

- (1) the cost of purchasing, installing and commissioning the RTO;
- (2) the cost of attempting to make the RTO functional; and
- (3) the cost of repairing the existing afterburner.

It was, however, presented at trial as 'the aggregate of the three categories [of loss] without specification of the amounts referable to each category'.<sup>39</sup> The Court of Appeal did not explain why the three categories could all be described as 'normal' loss. Indeed, at no stage did the court identify what it regarded as the 'normal measure of damages' for the breach or breaches which had been established. Given the importance attached to the concept, that is surprising. The absence of identification makes it difficult to understand the decision to hold that the amounts claimed under the first head of loss were not consequential losses.

Since the Court of Appeal treated the supply as having been made under a contract for the sale of goods,<sup>40</sup> the 'normal measure' stated in s 59(3) of the Goods Act 1958 (Vic) was presumably applicable. The measure stated in s 59(3) is the 'difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had answered to the warranty'. It would, to say the least, be difficult to characterise each component of the first head of loss as falling within that measure. To begin with, assuming that the RTO would have been worth approximately \$675,000 had it been in accordance with the contract, the maximum amount of 'normal loss' was \$675,000, plus incidental expenses. However, it was not proved that

<sup>38</sup> Cf *P & M Kaye Ltd v Hoster & Dickinson Ltd* [1972] 1 WLR 146.

<sup>39</sup> [2006] VSC 194 at [814] per Hansen J. The RTO was factored into the claim at a price of \$679,453 (see [2006] VSC 194 at [815]). However, Hansen J assumed that the correct figure was \$675,000.

<sup>40</sup> See eg [2008] VSCA 26 at [62].



the RTO supplied to Peerless was worthless. In fact, the RTO was far from worthless.<sup>41</sup>

Second, perhaps some aspects of the first head of loss could be justified by Peerless as reasonably incurred in attempts to mitigate its loss. That might account for the loss described as 'repairing the existing afterburner'.

Third, the first head of loss included an amount for 'attempting to make the RTO functional'. That sounds more like reinstatement costs, which may have been recoverable under s 59(2),<sup>42</sup> but could not be recovered under s 59(3).<sup>43</sup>

Fourth, both the cost of attempting to make the RTO functional and the cost of repairing the existing afterburner would seem to fall foul of the description 'expenses incurred through breach', which in *Environmental Systems* the Court of Appeal used to illustrate its understanding of the concept of 'consequential loss'.

### Loss of Profit and Black Holes

Another troubling feature of *Environmental Systems* is the view, apparently expressed, that it is possible to predict in advance types of loss which will fall into the consequential loss category. The Court of Appeal instanced 'profits lost or expenses incurred through breach' as categories of loss which must always be characterised as 'consequential'. This approach undermines whatever utility the *McGregor* view might have. That view clearly requires a court to characterise the contract and the nature of the breach and, having done so, to identify the applicable 'normal' measure. As explained above, that process was not employed by the court in *Environmental Systems*, which seems to have preferred an intuitive approach to what commercial people would regard as 'normal' loss.<sup>44</sup>

Under neither of the opposing views is it correct to regard loss of profit as necessarily being a consequential loss.<sup>45</sup> For example, in *Koufos v C Czarnikow Ltd*<sup>46</sup> the House of Lords clearly regarded the loss of profit sustained in that case, attributable to the difference between the market price at the time when goods ought to have arrived and the market price at the time when they arrived, as being a 'normal' loss, both in the sense of a 'natural' loss (the first limb of the rule in *Hadley v Baxendale*) and also a 'normal' loss in the sense of a prima facie loss (the *McGregor* view). Lord Reid made the

41 In discussing the claim for contravention of s 52 of the Trade Practices Act 1974 (Cth), Nettle JA said ([2008] VSCA 26 at [110]): 'So far as appears from the evidence, the RTO was worth \$675,000. Before Hansen J, the argument of counsel for Peerless was to the effect that "the RTO was not, by reason of an inherent defect, worth less than the price paid" (see [2006] VSC 194 at [929]).

42 Stating the first limb of the rule in *Hadley v Baxendale* in terms of the 'estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract'.

43 See *Bellgrove v Eldridge* (1954) 90 CLR 613 at 617.

44 Cf *Hotel Services Ltd v Hilton International Hotels (UK) Ltd* [2000] 1 All ER (Comm) 750; [2000] EWCA Civ 74 at [13].

45 Cf *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 at 600 per Rix J, affirmed without reference to the point [2000] 2 Lloyd's Rep 277 (*Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd's Rep 387 authority for the proposition that "'loss of profits" is prima facie an example of direct loss').

46 [1969] 1 AC 350.



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point<sup>47</sup> that, in both *Hadley v Baxendale* and *Koufos*, it was ‘not enough that in fact the plaintiff’s loss was directly caused by the defendant’s breach of contract. It clearly was so caused in both’. That seems manifestly inconsistent with the *Croudace* view of the application of the rule in *Hadley v Baxendale*.

Whether or not a plaintiff recovers a ‘loss of profit’ depends largely on whether it has made a good bargain. Loss of profit is recovered — or deemed to be recovered — under all conventional measures of loss of bargain damages. Whether *in fact* the promisee recovers a profit actually lost will depend on the circumstances. For example, assume that Seller agrees to sell 10 widgets to Buyer for \$150 and that the per-unit cost to Seller to manufacture a widget is \$10. If Buyer refuses to accept delivery, and the market price at that time is, say, \$12 per widget, Seller is *prima facie* entitled to damages equal to \$30. If, as the conventional (*prima facie*) measure presumes, Seller has sold 10 widgets on the market at \$12, the award of damages is as a matter of fact equal to the difference between the profit which Seller would have made under the contract with Buyer and the profit made under the subsequent contract. Of course, the difference in price measure is the classic example of ‘normal’ loss under the *McGregor* view. However, it is by no means inappropriate to say that Seller has recovered its actual loss.<sup>48</sup> More generally, although conventional measures do not relate directly to a plaintiff promisee’s actual loss of profit, in some contexts that is recoverable as a normal loss, as in *Koufos v C Zarnitkow Ltd*.<sup>49</sup> And even in *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*,<sup>50</sup> where the English Court of Appeal applied the second limb to deny recovery of actual profit lost, it acknowledged<sup>51</sup> the buyer’s right to recover for loss of business under the first limb.

Nevertheless, the real point is that, in most cases, a plaintiff’s *actual* profits will generally be recoverable — if at all — under the second limb of *Hadley v Baxendale*. From that perspective, the analysis in *Environmental Systems* owes more to the *Croudace* view than the court was willing to admit and is open to the objection that, where a normal measure of loss is applicable an exclusion of consequential loss achieves very little. There are, moreover, good reasons to believe that in *Environmental Systems* the court did not in fact apply

47 [1969] 1 AC 350 at 385.

48 Cf *Ian Stach Ltd v Baker Bosley Ltd* [1958] 2 QB 130 at 145. Contrast *Exxonmobil Sales and Supply Corp v Texaco Ltd (The Helene Knutsen)* [2003] 2 Lloyd’s Rep 686 at 691; [2003] EWHC 1964 (Comm) at [35] (exclusion of ‘loss of prospective profits’ did not prevent recovery by seller of damages for non-acceptance measured as the difference between the contract price and the market price).

49 See also *Cullinane v British ‘Rema’ Manufacturing Co Ltd* [1954] 1 QB 292; *Carr v J A Berriman Pty Ltd* (1953) 89 CLR 327; *T C Industrial Plant Pty Ltd v Robert’s Queensland Pty Ltd* (1963) 180 CLR 130. Cf *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] 1 All ER (Comm) 696; [2001] EWCA Civ 317 at [35] per Chadwick LJ, with whom Peter Gibson LJ and Buckley J agreed (‘loss of profits or other consequential losses’).

50 [1949] 2 KB 528.

51 [1949] 2 KB 528 at 543 per Asquith LJ, for the court (‘It does not, however, follow that the plaintiffs are precluded from recovering some general (and perhaps conjectural) sum for loss of business in respect of dyeing contracts to be reasonably expected, any more than in respect of laundering contracts to be reasonably expected’). See also *Regus (UK) Ltd v Epcot Solutions Ltd* [2008] EWCA Civ 361 at [28] per the court (‘Loss of profits are often thought of as consequential losses, but may well be direct’).



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the *McGregor* view. As already noted, having said that consequential loss includes 'expenses incurred through breach' it nevertheless permitted recovery of a loss (apparently in excess of \$500,000) which looks to have been of that nature. On the facts in *Environmental Systems*, the exclusion seems to have achieved much less than it should have achieved under the *McGregor* view.

If the *Croudace* view achieves too little in terms of content for an exclusion of liability for consequential loss, in one context at least it might be said that the *McGregor* view achieves too much. Application of the *McGregor* view to an exclusion of liability for consequential loss assumes that a normal measure of loss is applicable. Of course, that is not always the case. But that fact alone does not mean that the promisee is the victim of a 'black hole'. To take an obvious example, if a buyer refuses to accept delivery of goods and there is no available market, the seller is still entitled to damages. Under the sale of goods legislation, the relevant measure of damages is the 'estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract'.<sup>52</sup> That is, of course, the first limb of the rule in *Hadley v Baxendale*. How can the *McGregor* view be applied in such cases if there is no 'normal' loss? Presumably, two views are possible. It might be said that 'consequential loss' must refer to loss recoverable under the second limb, so that the result is the same as under the *Croudace* view. Alternatively, since there is no 'normal' loss, an exclusion of consequential loss is a total exclusion of liability. However, it would seem inherently unlikely that the parties envisaged an exclusion of consequential loss to have that effect. The correct approach, therefore, is to say that the promisee can recover its actual loss to the extent that the loss falls within the rule in *Hadley v Baxendale* but only to the extent that the loss is direct.

### Some Examples

The fact that the application of an exclusion clause is concerned with the scope of its operation as a matter of law rather than its linguistic meaning, does not mean that commercial parties should be deemed to have adopted a technical sense for the expression. If commercial people had a better understanding of the conventional measures of damage they might well draft their contracts accordingly. That is what *Environmental Systems* suggests they do. But they may or may not agree that the promisee can always recover under the conventional measure.

A more relevant sense of 'natural meaning' — applicable to both linguistic meaning and the scope of application of a clause — is 'commercial meaning'. It must be uncontroversial to say that an exclusion clause should be interpreted and applied in the way in which an ordinary commercial person would interpret and apply it. It must also be uncontroversial to say that if parties have spoken in terms of *consequential* loss, they must have some aspect of causation in mind. However, if one thing is clear about the exclusion clause cases in which the expression 'consequential loss' has been interpreted, it is that the decisions do not give effect to reasonable commercial expectations.

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<sup>52</sup> See eg Sale of Goods Act 1923 (NSW), s 52(2).



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That is not to say that it will necessarily be easy to construe a contract which includes an exclusion of liability for consequential loss. The actual wording of the clause is, of course, vitally important. For example, a very common set of words is:

A is not liable to B for any special, indirect or consequential loss.

It difficult to see such an exclusion as having three distinct elements. 'Indirect' means the same thing as 'consequential'. A court might therefore be inclined to see each element of the clause as relating to the same thing, and treat 'special' loss as the governing concept, that is, damages under the second limb of *Hadley v Baxendale*.<sup>53</sup> However, because it is wrong to assume that commercial parties will be precise in their terminology, in most situations the proper approach will be to read the clause as excluding liability for second limb damages ('special ... loss') and consequential loss ('indirect or consequential loss') otherwise recoverable under the first limb.

The structure of the contract is also important. A contract for the sale of goods may include a defects liability clause, that is, a provision which expressly requires the seller to remedy defects in goods which are detected within a particular period, or to pay to the buyer the cost of remedying the defects.<sup>54</sup> Such clauses are not exclusionary. At least, they are generally interpreted as providing additional or distinct remedies for the period during which they operate.<sup>55</sup> However, such a provision effectively entitles the buyer to compensation assessed on a basis which is not the normal measure. In those circumstances, the *McGregor* view could hardly be applied. It would be inconsistent with the defects liability clause to do so. One might also be forgiven for thinking that the parties cannot have intended the contract to provide the promisee with an express right of recovery of the cost of remedying the breach and, in addition, any loss that the buyer can bring within the first limb of the rule in *Hadley v Baxendale*. Yet that has been commonplace in the English cases applying the *Croudace* view.<sup>56</sup> The message of those decisions is that the defects liability clause should be stated to provide the sole remedy for defects in the goods.<sup>57</sup>

The nature of the obligations undertaken is another factor. Assume that A agrees to provide investment advice to B, and that the contract provides that A is not liable for consequential loss suffered by B. A is logically accepting some responsibility for negligent advice. But it would seem relatively

53 See *Pegler Ltd v Wang (UK) Ltd* [2000] BLR 218; 70 Con LR 68, where the clause referred to 'indirect, special or consequential loss' and Judge Bowsher QC applied the *Croudace* view and considered it reinforced by the closing statement in the clause, namely, 'even if ... advised of the possibility of such potential loss'.

54 See eg *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 42; *Pegler Ltd v Wang (UK) Ltd* [2000] BLR 218; 70 Con LR 68.

55 *Hancock v B W Brazier (Anerley) Ltd* [1966] 1 WLR 1317.

56 See eg *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 42. Since the case concerned a monetary limitation of liability for consequential loss, the court would also seem to have ignored the decisions in cases such as *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 WLR 964; [1983] 1 All ER 101, to the effect that the construction of a limitation of liability should be more generous than the construction of an exclusion of liability.

57 Cf *BHP Petroleum Ltd v British Steel Plc* [2000] 2 Lloyd's Rep 277 at 281, 288.



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straightforward to say that if, by following A's negligent advice, B incurs a loss of opportunity, namely, the opportunity to make a profitable investment, the exclusion of consequential loss protects A from liability for that loss. Theorising about measure of loss and the rule in *Hadley v Baxendale* ought to be irrelevant.

Such theorising ought also to be irrelevant in this example. Assume that A agrees to supply a mechanism to B which A knows will be used to join sections of a gas pipeline which B intends to place on the sea bed. There are, of course, other contractors. The problem for A is that if the mechanism fails the effects might be catastrophic in terms of the extent of A's damages exposure.<sup>58</sup> Assume that A and B agree that A's liability for consequential loss is excluded. What is the position if the mechanism fails? In order for B to deal with the problem it is necessary for B to bring the pipeline to the surface, repair it and re-lay it. Those costs must on any rational view be elements of a consequential loss.<sup>59</sup>

In none of the above examples would either the *Croudace* view or the *McGregor* view lead to what may be assumed to be the commercial objectives of the exclusion of liability for consequential loss. Of course, the conclusions suggested in each case may not be correct. That would depend on an analysis of the contract as a whole. Principles of commercial construction do not permit a court to approach any clause with a preconceived notion of its construction. Nevertheless, the losses identified as consequential losses in each example must be the sorts of losses which are prima facie within the clause. What seems patently obvious is that the correct conclusions cannot be reached — independently of an analysis of the contract as a whole — simply by applying a technical meaning to the expression 'consequential loss'.

Perhaps one of the reasons why courts have been reluctant to accept that 'consequential loss' refers to causation is the fear that application of the clause will leave the promisee without any effective claim. For example, assume that A agrees to supply and install a metal hopper which B will use to feed food to its livestock and that the contract excludes A's liability for consequential loss for negligent installation. If the hopper is not properly installed, so that food becomes mouldy and B's livestock die, A is not liable for the death of the livestock because that is a loss which is consequential on the negligent installation.<sup>60</sup> The fact that B may be without any effective remedy for breach of the agreement by A should not affect the matter. What is important is that a commercially sensible conclusion be reached.

## Conclusions

The impact of discussion above of the opposing views can be summarised as follows.

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58 In *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 42 the limitation of liability for consequential loss was the contract price, namely, about £106,585. But the claim for damages exceeded £5m.

59 See *Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd's Rep 387.

60 Cf the decision in *H Parsons (Livestock) Ltd v Uttley Ingham & Co Ltd* [1978] QB 791 (although not a 'normal' loss, damages recoverable as first limb loss).



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- The essence of the *Croudace* view is that ‘consequential’ means ‘special’ in the sense that it is an unusual loss. An exclusion of consequential loss does not protect the promisor against any loss, no matter how far removed in terms of causation, which is recoverable under the first limb of the rule in *Hadley v Baxendale*.
- The essence of the *McGregor* view is that anything beyond (or other than) the normal or conventional measure of damages applicable to the breach is ‘consequential’ even though, as a matter of fact, some such losses must be ‘direct and immediate’. Unless it happens to coincide with the conventional measure, an exclusion of consequential loss excludes part or all of the promisee’s actual loss.

Although it seems clearly wrong to treat the scope of the expression ‘consequential loss’ as determined by the rule of remoteness (the *Croudace* view), there is no a priori reason for thinking that the expression is concerned with measure of damage (the *McGregor* view). From this perspective, both views are artificial. Each relies on a conceptual approach under which the expression ‘consequential loss’ is associated with a particular legal effect. Both are wrong because they approach the expression ‘consequential loss’ from particular legal perspectives rather than a commercial perspective which will vary from case to case. Neither view has been adopted by the highest tribunals. And, in relation to the *Croudace* view it may be significant that in *Caledonia North Sea Ltd v British Telecommunications Plc*<sup>61</sup> Lord Hoffmann went out of his way to ‘reserve the question’ whether the construction of ‘indirect or consequential losses’ in cases applying the *Croudace* view was correct. Whether the High Court of Australia will approve the adoption of the *McGregor* view in *Environmental Systems* also remains to be seen.

In a negotiated contract, the factors and considerations which influence the parties’ choice of terms and the drafting of those terms vary from contract to contract. That includes the exclusionary provisions of the contract. No two contracts are likely to be the same. From the perspective of the supplier of goods or services — as the party who is more likely to be concerned to exclude or limit liability — the factors and considerations may include:

- indeterminacy of the extent of exposure;
- concerns to be insulated from matters peculiar to the promisee;
- insurance arrangements;
- bargaining power;
- statutory restrictions on the use of certain types of clauses; and
- the relevance of the particular formulation to the nature of the subject matter being supplied.

Such factors and considerations influence both the content of the exclusions and the way in which they are drafted. Given the opposing views on the subject of ‘consequential loss’, it may be that a supplier is ill-advised to rely on such an exclusion. Indeed, given that 30 years have elapsed since the decision in *Croudace* it seems remarkable that English contracts continue to employ the terminology. If nothing else, this seems good evidence that commercial people (and many of their lawyers) do not read law reports!

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61 [2002] 1 Lloyd’s Rep 553 at 572.



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It is not the function of a court called upon to construe a contract to determine meanings on a 'once for all' basis. Nor is it the function of a court to determine all the possible applications of a clause. The function is to resolve the particular dispute that has arisen. 'Meaning' need only be determined so far as it is necessary to do so, and the only 'application' which has to be determined is the application of the clause to the particular facts which have arisen. Those who think otherwise make the mistake made by Fry J in *Holt & Co v Collyer*. Thus, notwithstanding that the goal which Fry J set himself in *Holt & Co v Collyer* was impossible, courts in both England and Australia seem to be satisfied that it has been largely achieved in relation to 'consequential loss'.