

# Queensland Competition Authority

Position Paper

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## Aurizon Network's 2019 draft amending access undertaking

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September 2019

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## SUBMISSIONS

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Closing date for submissions: 30 October 2019

This document represents the Queensland Competition Authority's (QCA's) preliminary view and is intended to give stakeholders an insight into that view to encourage further contributions. The QCA's application of statutory assessment criteria and its thinking may change towards its final decision, which will be informed by submissions made in response to this document. This document is not a draft version of a final decision, and it has no force of itself. There should be no expectation that it presents views and recommendations which will prevail to the end of the decision making process.

Public involvement is an important element of the decision-making processes of the QCA. Therefore submissions are invited from interested parties concerning its assessment of Aurizon Network's UT5 DAAU. The QCA will take account of all submissions received within the stated timeframes.

Submissions, comments or inquiries regarding this paper should be directed to:

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[www.qca.org.au/submissions](http://www.qca.org.au/submissions)

### Confidentiality

In the interests of transparency and to promote informed discussion and consultation, we intend to make all submissions publicly available. However, if a person making a submission believes that information in the submission is confidential, that person should claim confidentiality in respect of the document (or the relevant part of the document) at the time the submission is given to us and state the basis for the confidentiality claim.

The assessment of confidentiality claims will be made by the QCA in accordance with the *Queensland Competition Authority Act 1997*, including an assessment of whether disclosure of the information would damage the person's commercial activities and considerations of the public interest.

Claims for confidentiality should be clearly noted on the front page of the submission. The relevant sections of the submission should also be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two versions of the submission (i.e. a complete version and another excising confidential information) could be provided.

A confidentiality claim template is available on request. We encourage stakeholders to use this template when making confidentiality claims. The confidentiality claim template provides guidance on the type of information that would assist our assessment of claims for confidentiality.

### Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at our Brisbane office, or on our website at [www.qca.org.au](http://www.qca.org.au). If you experience any difficulty gaining access to documents please contact us on (07) 3222 0555.

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## SUMMARY

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On 3 May 2019, Aurizon Network submitted a voluntary draft amending access undertaking (UT5 DAAU) to the Queensland Competition Authority (QCA) under s. 142 of the *Queensland Competition Authority Act 1997* (QCA Act), seeking amendments to its approved 2017 Undertaking (UT5 Undertaking).

This Position Paper is intended to provide stakeholders with an insight into our preliminary views and encourage further contributions by way of submissions. Our assessment may change when we make our decision, which will be informed by submissions made in response to this Position Paper.

In consultation with coal producer representatives, Aurizon Network has subsequently identified and requested a number of revisions to its UT5 DAAU for us to consider in this investigation. While we have incorporated this information within our preliminary views, we acknowledge that this may be the first opportunity for stakeholders to provide comments. In this regard, we are particularly interested in submissions from interested parties that provide their views on our preliminary positions.

It is our preliminary view that Aurizon Network's UT5 DAAU would be appropriate to approve subject to the amendments identified in this Position Paper.<sup>1</sup> These amendments are consolidated in the 'Revised UT5 DAAU' at Appendix 1.<sup>2</sup>

We have also published the information requests made, and responses provided, during the investigation and encourages stakeholders to consider this material (Appendix 2).

This Position Paper seeks comments on our views about the appropriateness of Aurizon Network's UT5 DAAU, including the proposed amendments as outlined in the Revised UT5 DAAU at Appendix 1.

We invite interested parties to make a written submission to us by 30 October 2019.

### QCA preliminary view

We consider that the Revised UT5 DAAU (Appendix 1) would be appropriate to approve because:

- It meets all relevant requirements of the QCA Act.
- We have not identified any material competitive detriments.
- Aurizon Network has reached consensus as to the arrangements to apply to coal producers that as a package present a significant number of increased and material benefits from their perspective.
- Aurizon Network and coal producer representatives have identified a number of revisions that address a range of issues with the initial proposal.<sup>3</sup>

We note that these consensus positions have been developed in consultation with a diverse and overwhelming number of coal producers — this includes coal producers that have:

- relatively large or small mining operations;
- interests in different coal systems; and

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<sup>1</sup> In light of revisions requested by Aurizon Network, we do not consider it is appropriate to approve the initial proposal, after having regard to the statutory criteria.

<sup>2</sup> These also reflect recently QCA approved amendments from 24 June 2019 and 18 July 2019.

<sup>3</sup> This also includes a number of cross referencing issues and other consequential amendments which, while not discussed in detail within this Position Paper, have been assessed by us.

- interests in expanding operations (access seekers), or not expanding operations (access holders).

We have considered the views presented in stakeholder submissions.<sup>4</sup>

Subject to stakeholder views provided in response to this Position Paper, we consider that if Aurizon Network submitted an amended UT5 DAAU, which incorporated the amendments outlined in the Revised UT5 DAAU, we would be minded to approve the proposal.

## Submissions invited on areas of particular interest to the QCA

While we are seeking submissions on all aspects of the proposed UT5 DAAU arrangements, there are a number of matters that would benefit from stakeholder views and these are identified in this document. For example:

- Proposed amendments that have consequential impacts on non-coal traffics — given the proposed arrangements were developed with coal producers, we seek stakeholder views as to whether these are appropriate to approve.
- Proposed voting arrangements for certain decisions — although we note that these consensus positions have been developed with a diverse and overwhelming number of coal producers, we seek stakeholder views as to whether these are appropriate to approve.
- Proposed arrangements for circumstances where Aurizon Network and a majority of end users cannot agree the appointment of the Independent Expert — progressing these matters through the dispute resolution processes (Part 11) to enable these parties to directly appoint the Independent Expert.

Views on these matters will assist us in making its forthcoming decision on Aurizon Network's UT5 DAAU, including the amendments necessary to secure our approval.

## Aurizon Network's UT5 DAAU

Aurizon Network's UT5 DAAU has been developed following detailed consultation with coal producers and represents a package of amendments to Aurizon Network's existing UT5 Undertaking arrangements.

Amongst other things, Aurizon Network is seeking the following amendments to its UT5 Undertaking:

- Extending the term of the UT5 Undertaking to 30 June 2027 with processes to reset allowable revenues and reference tariffs for the reset period (2023–24 to 2026–27) (section 1.8).
- Increasing the Approved WACC from 5.7% to 5.9% (from 3 May 2019), with a further 0.4% increase following certain milestones related to the Initial Capacity Assessment Report, and a 0.3% reduction to apply where the rebate mechanism ceases to apply (section 1.5).
- Maintenance allowances to be developed on an annual basis from 1 July 2021, with processes for direct customer involvement in developing maintenance strategies and budgets. Where Aurizon Network does not obtain pre-approval from end users, the QCA assesses and determines the annual maintenance strategy and budget (section 1.2).
- The QCA determining the extent to which annual maintenance cost claims are consistent with approved maintenance strategies and budgets from 1 July 2021, with adjustments to reference tariffs to reflect QCA approved maintenance expenditure (section 1.2).
- A new role for an Independent Expert to undertake a range of tasks (section 2.1), including:

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<sup>4</sup> A list of submissions is provided at Appendix A.

- Determination of capacity of the below-rail network and broader supply chain, identifying existing capacity deficits and making recommendations on how these should be addressed.
- Determination of the system operating parameters for planning and contracting purposes.
- Reviewing performance information and network service quality as well as providing monthly performance reports to relevant parties.
- Participating in network development plans and a consultation role within demand assessments for access seekers and provisional capacity allocations to access holders.
- Various mechanisms that involve voting thresholds that provide, amongst other things, pre-approval and approval processes that bind Aurizon Network.
- Aurizon Network funding expansions to address capacity deficits identified by the Independent Expert's initial capacity assessment agreed by end customers, or failing agreement as determined by the QCA, up to \$300 million in total (section 4.3).
- Aurizon Network committing to fund expansions (up to \$30 million per annum, with carry-forward provisions) that benefit more than one access seeker/holder or customer (section 4.2).
- Revised ring-fencing and governance arrangements, including incorporation of an independent observer at Aurizon Network Board meetings, and a customer voting process to approve proposed transfer of key Aurizon personnel between Aurizon Network and its related parties (section 5.1).
- Development of a 'Rail Industry Group' to facilitate consultation on a range of matters, including proposed maintenance and renewals strategies and budgets, as well as associated governance processes for pre-approval of maintenance and renewals (sections 1.2 and 5.3).
- A rebate is payable by Aurizon Network where the Independent Expert identifies that there has been a contractual capacity shortfall due to Aurizon Network breaching its contractual/undertaking obligations. A QCA review process will occur in January 2023 to assess whether the rebate mechanism is achieving its objectives (section 2.3).

Subject to issues raised in submissions, our view is that the Revised UT5 DAAU would be appropriate to approve for the purposes of s. 138(2) of the QCA Act.

### The QCA's assessment process

In accordance with s. 142 of the QCA Act, we must consider Aurizon Network's UT5 DAAU and either approve, or refuse to approve, it. In doing so, we must publish Aurizon Network's UT5 DAAU and consider comments on it.

If we refuse to approve Aurizon Network's UT5 DAAU, we must provide a written notice stating the reasons for the refusal and the way in which we consider it is appropriate to amend Aurizon Network's UT5 DAAU. This Position Paper seeks comments on our views about the appropriateness of Aurizon Network's UT5 DAAU, including the proposed amendments as outlined in the Revised UT5 DAAU at Appendix 1.

Our preliminary views have been developed after considering Aurizon Network's UT5 DAAU in accordance with the statutory assessment criteria in s. 138(2) and other applicable requirements of the QCA Act.

We have also considered submissions received from stakeholders to date,<sup>5</sup> and will also consider all submissions provided by the stated deadline.

### Consideration of consensus positions between Aurizon Network and coal producers

Our role under the QCA Act is to decide whether amendments to an approved access undertaking are appropriate to approve and, if not, what changes we consider appropriate to be made. As such, we would not be performing our statutory role if we accepted a draft amending access undertaking merely because it had been agreed with some or all coal producers—nor could we focus our assessment of a draft amending access undertaking on only those parts that are in dispute between Aurizon Network and coal producers.

Nonetheless, provisions presented by stakeholders on a consensus basis are relevant in our assessment of Aurizon Network's UT5 DAAU. The significance of this factor will depend (amongst other things) on the stakeholders involved in developing consensus positions, the level of support expressed by stakeholders, and the matter involved. Consequently, the greater, more widespread and extensive the support from stakeholders, the more weight we give to consensus positions.

In this regard, we note that consensus positions that affect coal producers (access holders/seekers) have been developed with a diverse and overwhelming number of coal producers, specifically:

- Anglo American Metallurgical Coal
- BHP Billiton Mitsui Coal
- BMA Coal Operations
- Byerwen Coal
- Coronado Curragh
- Ensham Resources
- Hail Creek Coal Holdings
- Jellinbah Mining
- Kestrel Coal Resources
- Lake Vermont Resources
- Middlemount Coal
- Peabody Energy Australia PCI
- Peabody Energy Australia
- QCoal Group
- Yarrabee Coal Company
- Adani Mining

We also note that related parties of Aurizon Network, Aurizon Holdings and Aurizon Operations, also submitted in support of the UT5 DAAU.

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<sup>5</sup> A list of submissions is provided at Appendix A.



Nevertheless, we must also consider the effect of amendments on all stakeholders, including train operators, future access seekers and non-coal traffics, who are not necessarily represented by the coal producers that developed consensus positions. Moreover, our broader considerations also include the public interest. Accordingly, while the existence of stakeholder-consensus positions is persuasive, it is not decisive.

### Next steps

We invite submissions from interested parties by 30 October 2019. All submissions made by this date will be taken into consideration before we make our decision on Aurizon Network's UT5 DAAU. Stakeholders are encouraged to provide focused, detailed responses to our preliminary views and proposed amendments we consider necessary for approval, as outlined in the Revised UT5 DAAU at Appendix 1. Where possible, information and evidence should be provided in support of arguments advanced in submissions.

# 1 COSTS, REFERENCE TARIFFS AND ALLOWABLE REVENUES

Aurizon Network has proposed a number of amendments to the processes associated with reference tariffs and allowable revenues. This chapter considers the proposed amendments that relate to the following:

- Revised reference tariffs and allowable revenues (section 1.1)
- Maintenance matters (section 1.2)
- Operating costs (section 1.3)
- Asset replacement and renewals (section 1.4)
- Approved WACC (section 1.5)
- Annual capital expenditure reconciliation (section 1.6)
- Tax allowance annual review update (section 1.7)
- Extension of Schedule F values - Reset period, Part 6A (section 1.8)

## 1.1 Revised reference tariffs and allowable revenues

Aurizon Network has proposed reference tariffs and allowable revenues that reflect the consensus arrangements that underpin its UT5 DAAU. Aurizon Network has sought revisions to the AT5 and EC tariff components to be consistent with the reallocation of variable connection charges in our decision on the electric traction pricing arrangements.

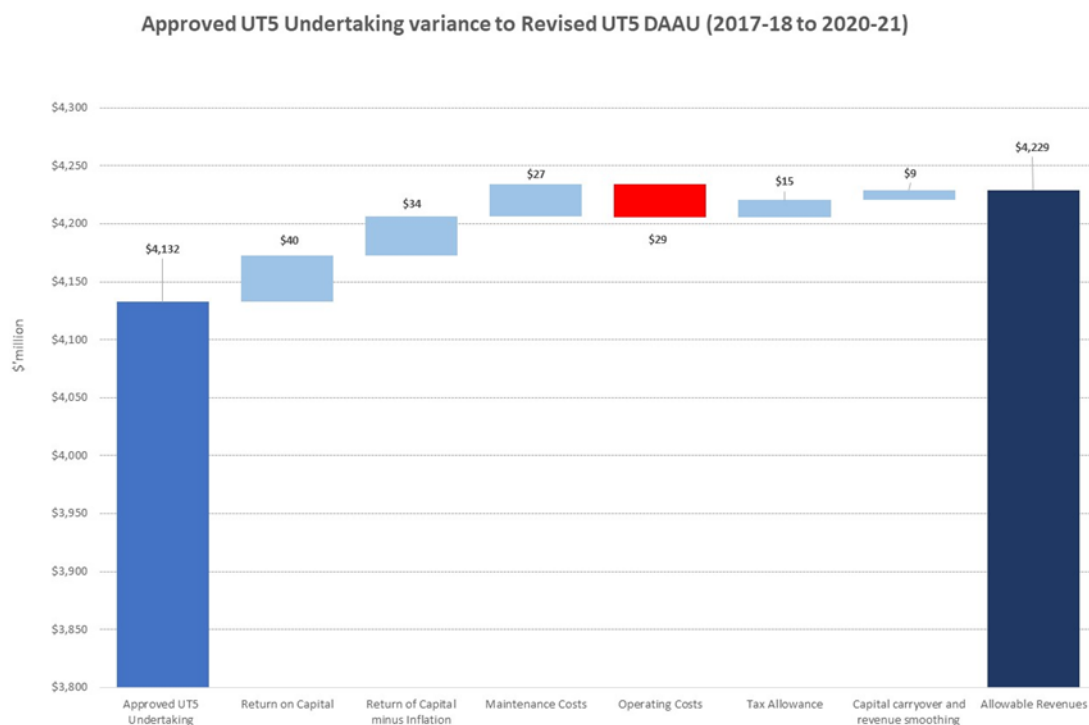
Aurizon Network has also proposed a new Schedule K forecasting allowable revenues for the period from 1 July 2017 to 30 June 2023. These values are shown in the Revised UT5 DAAU and summarised below.

**Table 1 Schedule K values**

<i>Total CQCN (\$m)</i>	<i>2017–18</i>	<i>2018–19</i>	<i>2019–20</i>	<i>2020–21</i>	<i>2021–22</i>	<i>2022–23</i>
Capital Indicator	<b>218.7</b>	<b>190.0</b>	<b>232.2</b>	<b>231.0</b>	<b>231.0</b>	<b>231.0</b>
Return on Capital	341.9	345.3	361.8	372.1	368.5	364.0
Return of Capital minus Inflation	246.4	245.2	304.0	278.3	294.8	290.9
Direct Maintenance Costs	223.7	205.7	155.1	158.1	158.1	158.1
Indirect Maintenance Costs	9.1	9.5	10.8	10.2	10.2	10.2
Electric Operating Expenditure	70.2	59.7	57.2	60.6	62.4	64.2
Non-Electric Operating Expenditure	117.4	120.7	132.7	135.1	135.1	135.1
Tax Allowance	38.5	38.0	54.9	54.6	51.9	51.1
Capital Carryover	0	0	6.0	6.2	6.3	6.5
<b>Allowable Revenue</b>	<b>1,047.2</b>	<b>1,024.1</b>	<b>1,082.5</b>	<b>1,075.2</b>	<b>1,087.2</b>	<b>1,080.0</b>

## Key differences from approved UT5 Undertaking and the Revised UT5 DAAU<sup>6</sup>

The figure below shows the variation in the allowable revenue from the approved UT5 Undertaking to the Revised UT5 DAAU, over the period 2017–18 to 2020–21.<sup>7</sup>



The key drivers arises from:

- Increases to the return on capital and tax allowances. Forecast reference tariffs and allowable revenues are based on the Approved WACC increasing to:
  - 5.90 percent from 3 May 2019
  - 6.30 percent after certain milestone are satisfied

The processes by which the Approved WACC is reviewed and assessed are discussed in section 1.5.

- Increases to depreciation charges (\$34 million) due to capital expenditure within the recently approved roll-forward of the regulated asset base.
- Operating expenditure decreasing by \$29 million due to updated forecasts of transmission and connection charges from transmission service providers, as well as the reallocation of variable connection charges from the AT5 to the EC tariff component.
- Maintenance costs increasing in 2019–20 and 2020–21 by \$27 million due to expensing of certain ballast undercutting costs rather than capitalising these items. The processes by which ballast undercutting costs are reviewed and assessed are discussed in section 1.4.4.

<sup>6</sup> The approved UT5 Undertaking reflects recent QCA approved amendments from 24 June 2019 and 18 July 2019.

<sup>7</sup>This figure is derived from financial models submitted by Aurizon Network on 13 September 2019.

## QCA analysis and preliminary position

Our preliminary view is that the proposed allowable revenues and reference tariffs contained in the Revised UT5 DAAU are appropriate to approve.

We have assessed the calculations that underpin the allowable revenues and reference tariffs and consider these reflect the package supported by Aurizon Network and coal producers. We note that a diverse and overwhelming number of coal producers have made their own assessment of the commercial and regulatory risks that will affect Aurizon Network by supporting the UT5 DAAU, namely:

- Anglo American Metallurgical Coal
- BHP Billiton Mitsui Coal
- BMA Coal Operations
- Byerwen Coal
- Coronado Curragh
- Ensham Resources
- Hail Creek Coal Holdings
- Jellinbah Mining
- Kestrel Coal Resources
- Lake Vermont Resources
- Middlemount Coal
- Peabody Energy Australia PCI
- Peabody Energy Australia
- QCoal Group
- Yarrabee Coal Company
- Adani Mining

New Hope Group was the only submission that questioned the proposed amendments, in terms of the overall cost impact.

This creates a question for New Hope as it potentially attracts additional costs for below rail services in that:

- Aurizon Network receives an increase in its Weighted Average Cost of Capital which will lift overall access charges;
- Coal producers will also have to directly or indirectly fund the establishment and operation of the Independent Expert; and
- Depending on the modelling outcomes delivered by the Independent Expert, there is increased risk that there may be a requirement for additional capital expenditure on below rail infrastructure, which will also have the end effect of increasing access charges if this capital expenditure is included in Aurizon Network's Regulated Asset Base.

Accordingly, New Hope's over-arching query is whether the nature of the bargain agreed under the UT5 DAAU has the effect of potentially imposing unquantified additional costs onto the below rail component of the supply chains that operate within the Central Queensland region. In particular, these additional costs may pose a disproportionate risk to new projects which are

more sensitive than existing established operations to additional fixed costs. Is the QCA satisfied that the magnitude of this potential increase in costs is understood and in overall terms can be considered to be economically efficient and consistent with the objectives of the Queensland Competition Authority Act, 1997?<sup>8</sup>

While we note that additional costs are relevant considerations for access seekers/holders, we also note that these additional costs are part of the proposed package of amendments. The identification of additional costs *per se* is not sufficient grounds for us to not approve Aurizon Network's UT5 DAAU. The key considerations for us are whether the:

- proposed additional costs will be efficiently incurred;
- arrangements provide incentives to reduce costs or otherwise improve productivity; and
- return on investment is commensurate with the regulatory and commercial risks involved.

Our preliminary view is that the interests of coal producers (access seekers/ holders) are advanced by, among other things:

- Having direct involvement and the ability to pre-approve maintenance strategies and budgets, as well as the QCA's role in assessing the efficiency and prudence of maintenance costs on an annual basis, which gives greater certainty that these costs will be incurred efficiently (section 1.2).
- Aurizon Network having improved incentives to reduce costs or otherwise improve productivity of the provision of below-rail services in relation to operating costs (section 1.3). Providing incentives to reveal efficient costs, over time, is in the interests of all parties.
- Having direct involvement in development of the asset replacement and renewals strategy and budget in the below-rail network (section 1.4).
- A right to a rebate payment in specified circumstances involving non-performance by Aurizon Network of its obligations to provide Train Service Entitlements, as determined by the Independent Expert (section 2.3).
- Having greater certainty that capacity is available by means of the Independent Expert's capacity assessments (section 2.2.1).

We note that a diverse and overwhelming number of coal producers (access seekers/holders) have submitted in support of the package of amendments. In this regard, the consensus positions present an alignment of interests, in that coal producers (access seekers/holders) are not incentivised to support provisions that increase costs without receiving corresponding benefits. We have not identified any material detriments to competition, including barriers to entry from these amendments. We also consider that end users will be incentivised to seek efficiency in the costs, for example costs of the Independent Expert, given they will ultimately be paying these costs through access charges.

For these reasons, and when considered overall as a package of amendments, we are minded to approve the Revised UT5 DAAU as it relates to costs, reference tariffs and allowable revenues. We welcome stakeholder comments on our preliminary views.

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<sup>8</sup> New Hope Group, sub. 23: 2.

We note Rio Tinto's transparency concerns associated with bullet payments and/or rebates associated with implementing the UT5 WACC, including any transition to the UT5 DAAU.<sup>9</sup> We previously considered the reconciliation of 2017-18 transitional and adjusted allowable revenues and approved the variance being incorporated in the 2018-19 adjusted allowable revenues.<sup>10</sup> In relation to rebates and GAPE Deed payments,<sup>11</sup> we note that these are contractual matters for the parties.

## 1.2 Maintenance matters

Part 7A.11 of Aurizon Network's proposal incorporates new obligations in relation to the assessment and approval of maintenance costs. This includes a process for the pre-approval of a maintenance strategy and budget, and an *ex-post* assessment process where allowable revenues are adjusted to reflect actual maintenance expenditure approved by the QCA. The proposal also incorporates new obligations outlining the manner in which Aurizon Network must complete its maintenance work.

Aurizon Network's proposed maintenance obligations under Part 7A.11 relate to its direct maintenance costs, including depreciation costs associated with maintenance plant.<sup>12</sup> The assessment and approval of indirect maintenance costs (the return on maintenance plant and inventory) is subject to the processes in Part 6A of Aurizon Network's UT5 DAAU (section 1.8).

### 1.2.1 Aurizon Network's proposed maintenance objectives

Aurizon Network's proposal outlines how Aurizon Network must carry out its maintenance work, irrespective of the maintenance and operating allowance provided (cl. 7A.11.1). Aurizon Network will be required to ensure maintenance work is undertaken in a manner consistent with its approved maintenance strategy and budget (discussed below).<sup>13</sup> However, in specific circumstances, the proposal allows for inconsistency with the approved strategy and budget. Broadly, these circumstances occur where Aurizon Network considers it prudent and efficient or necessary, in relation to safety, reliability or performance of the rail infrastructure.

Aurizon Network's proposal requires that when viewed holistically, Aurizon Network exercises the due care and skill expected of an experienced operator and manager who has regard to:

- seeking to ensure that committed capacity is delivered;
- appropriately balancing cost, reliability and performance each in respect of the rail infrastructure; and
- coordinating outages with other supply chain participants wherever reasonably possible with a view to maximising throughput.

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<sup>9</sup> Rio Tinto, sub. 24.

<sup>10</sup> Queensland Competition Authority (QCA), *Aurizon Network's Reference Tariff Variation DAAU*, decision, June 2019.

<sup>11</sup> Rio Tinto, sub. 24.

<sup>12</sup> Depreciation costs will be recovered through the direct maintenance cost allowance as they form part of the plant rates charged to each job that is executed. Aurizon Network, Response to QCA RFI question 42, 23 July 2019, p. 13.

<sup>13</sup> Prior to the first approved maintenance strategy and budget in 2020–21, maintenance work must be conducted in a manner consistent with the QCA's 2018 Decision (approved maintenance approach).

This requirement is subject to the approved maintenance strategy and budget applicable at the time.<sup>14</sup>

Aurizon Network must undertake maintenance work in a manner that is consistent with the system operating parameters.

### 1.2.2 Pre-approval of a maintenance strategy and budget

Aurizon Network's proposal provides a process for annually approving a maintenance strategy and budget on an *ex-ante* basis.

From 2020–21, Aurizon Network will develop a maintenance strategy and budget that must include a range of information such as:

- the scope of work with key deliverables identified;
- a budget for the scope of work;
- a description of the maintenance practices, procurement strategies and methodology Aurizon Network will apply; and
- a description of the impact on coal systems, supply chains and forecast throughput.

The maintenance strategy and budget must be consistent with Aurizon Network's maintenance objectives to seek to ensure that committed capacity is delivered and to coordinate outages with other supply chain participants.

Aurizon Network's maintenance strategy and budget may be approved by voting end users. Aurizon Network is required to provide a draft of its maintenance strategy and budget to the Rail Industry Group and non-coal access holders and customers<sup>15</sup> and engage with its members on related matters, before voting end users decide whether they will approve the strategy and budget (cl. 7A.11.3). The Revised UT5 DAAU specifies that a special majority of end users may appoint an expert advisor who may attend meetings and discussions between Aurizon Network and members of the Rail Industry Group and consider confidential information in relation to Aurizon Network's draft Maintenance Strategy and Budget (cl. 7A.11.3).

Maintenance costs consistent with the approved strategy and budget will be included in the allowable revenue, as a maintenance indicator (cl. 7A.11.4). The proposal includes obligations in Schedule F that annually adjust allowable revenues and reference tariffs to reflect the maintenance indicator (Schedule F, cl. 4.1).

Maintenance costs will be subject to an *ex-post* assessment. However, so long as Aurizon Network's actual expenditure is consistent with the approved maintenance strategy and budget, they will be recovered by Aurizon Network. This is discussed in section 1.2.3.

#### Where Aurizon Network and voting end users do not agree

Where end users do not vote in favour of Aurizon Network's maintenance strategy and budget, and agreement cannot be reached between the parties, the QCA must determine the maintenance strategy and budget to apply. In doing so, the QCA will form a view on whether the activities and costs specified in Aurizon Network's draft maintenance strategy and budget are prudent and efficient.

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<sup>14</sup> Or the approved maintenance approach.

<sup>15</sup> Aurizon Network, Response to QCA RFI question 44, 23 July 2019, p. 14.

It should be noted that this role is considerably different to our role under the existing framework. Currently, we approve a forecast maintenance allowance on a forward-looking basis, with Aurizon Network determining its own strategy and budget. We do not set how Aurizon Network should carry out its maintenance work, nor specify how the allowance must be spent.

### 1.2.3 Assessment of actual maintenance expenditure

Aurizon Network's proposal includes a process that adjusts allowable revenue and reference tariffs, for actual maintenance expenditure approved by the QCA. As such, Aurizon Network will be able to recover its actual maintenance expenditure.

From 2018–19, Aurizon Network must submit an annual maintenance cost claim to the QCA, outlining its actual expenditure. The maintenance cost claim will also identify any items in the approved maintenance strategy and budget that were not undertaken and items where Aurizon Network spent at least \$2 million less than budgeted. In addition, Aurizon Network will provide information on the scope of work undertaken and the procurement strategy and methodology applied (cl. 7A.11.5 (c)).

Where the maintenance cost claim is consistent with the approved maintenance strategy and budget, the QCA must approve Aurizon Network's actual expenditure (cl. 7A.11.5 (f)). Where there are material differences between the maintenance cost claim submitted and the approved maintenance strategy and budget, the QCA is required to assess those maintenance costs and activities, and approve materially different costs and activities to the extent these are considered prudent and efficient (cl. 7A.11.5 (h)). Allowable revenue and reference tariffs will be adjusted through Schedule F to reflect the QCA's decision (Schedule F, cl. 4.3).

As there will be no approved maintenance strategy and budget for 2018–19 and 2019–20, Aurizon Network's maintenance cost claim will be compared against costs provided in the QCA's 2018 Decision. The Revised UT5 DAAU specifies that in 2018–19, the lower of the maintenance cost claim and the aggregate direct maintenance costs in the QCA's 2018 Decision will be approved by the QCA. In 2019–20, the lower of the maintenance cost claim by coal system and the direct maintenance costs in the QCA's UT5 2018 Decision by coal system, will be approved by the QCA. Adjustments will be made through Schedule F to account for the QCA approved maintenance costs (Schedule F, cl. 4.3).<sup>16</sup>

Aurizon Network has clarified that actual maintenance costs for 2017–18 will not be submitted to, nor assessed by, the QCA under its UT5 DAAU proposal. Aurizon Network stated that its actual maintenance expenditure was above costs provided in the QCA's 2018 Decision and, as such, no adjustment is required through Schedule F.<sup>17</sup>

### 1.2.4 QCA's analysis and preliminary views

We are currently minded to approve Part 7A.11 and related maintenance matters as outlined in the Revised UT5 DAAU at Appendix 1.

We acknowledge that how Aurizon Network carries out its maintenance work may impact the scheduling of train services and operation of the supply chain. This has the potential to affect throughput, which is a key consideration for coal producers. Aurizon Network's inclusion of

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<sup>16</sup> Aurizon Network, Response to QCA RFI question 4, 17 September 2019, p. 2.

<sup>17</sup> Aurizon Network, Response to QCA RFI question 45, 23 July 2019, p. 14.



obligations that specify how it must carry out its maintenance work, and obligations that allow direct end user involvement in determining the maintenance strategy and budget would be expected to provide a greater level of clarity and transparency on the interactions between maintenance activities and throughput.

While providing for the recovery of actual maintenance expenditure could diminish incentives to reduce costs and implement productivity improvements, we consider that Aurizon Network's proposal includes appropriate mechanisms to promote efficient maintenance expenditure. This includes the process for approving the maintenance strategy and budget, and requirements for the QCA to assess prudence and efficiency of any actual expenditure different to the approved strategy and budget.

We note that Aurizon Network is incentivised to work with end users to reach agreement on the maintenance strategy and budget to apply. If agreement cannot be reached, Aurizon Network must follow the QCA determined strategy and budget or risk not recovering actual expenditure through the *ex-post* assessment process. Inconsistency with the QCA determined strategy and budget could also lead to an 'AN Performance Breach' and Aurizon Network paying a performance rebate to end users (see section 2.3 for detail on the rebate mechanism).

Aurizon Network has requested a revision to its proposal that provides guidance on what is considered a material difference between the maintenance cost claim and the approved maintenance strategy and budget, when assessing actual maintenance expenditure. The requested revision provides a threshold for what will be considered a material difference through reference to clauses 7A.11. 5 (f)(ii)(B)(2)–(4).<sup>18</sup> We are currently minded to approve this revision, noting that it sets clear and transparent expectations on what the QCA is expected to assess. This revision is reflected in the Revised UT5 DAAU.

A number of submissions sought the involvement of additional supply chain participants in maintenance decision-making processes, including the approval of the maintenance strategy and budget. Pacific National considered that all supply chain participants should be given the option to participate in decision making processes pertaining to maintenance, so that their interests can be considered.<sup>19</sup> The Gladstone Ports Corporation considered that there may be matters addressed in the maintenance strategy and budget that could have a material impact on port and terminal operations and it should therefore have the ability to engage in good faith discussions in relation to the draft maintenance strategy.<sup>20, 21</sup>

We note that the existing UT5 Undertaking does not require Aurizon Network to consult with supply chain participants when determining its maintenance strategy and budget. Further, while under the existing framework the QCA approves a forecast maintenance allowance, we do not prescribe how Aurizon Network should carry out its maintenance work. It is up to Aurizon Network to set its maintenance strategy and budget. Aurizon Network is proposing a significant level of engagement with supply chain participants in relation to maintenance matters — for example:

- Aurizon Network's proposal contains obligations that require it to consider and consult with all supply chain participants. Aurizon Network must cooperate and coordinate with all

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<sup>18</sup> Aurizon Network, Response to QCA RFI question 3, 27 August 2019, p. 2.

<sup>19</sup> Pacific National, sub. 22: 3.

<sup>20</sup> Gladstone Ports Corporation, sub. 21: 3.

<sup>21</sup> Gladstone Ports Corporation considered it should be included in the Rail Industry Group for this purpose.

elements of the supply chain with a view to maximising the efficiency and performance of the relevant supply chain. Further, in planning and implementing operational constraints, Aurizon Network must, to the extent practicable, minimise disruption to the operation of train services (cl. 7A.8.3).<sup>22</sup>

- Aurizon Network's proposal includes supply chain group obligations that require Aurizon Network to participate in discussions with supply chain participants and service providers to seek to ensure the coordination of maintenance activities (cl. 7A.8.2 (a)(iii)). This should allow the Gladstone Ports Corporation reasonable opportunity to engage discussions with Aurizon Network on maintenance matters.
- Aurizon Network is also required to ensure its maintenance strategy and budget is consistent with certain maintenance objectives, including an obligation to coordinate outages with other supply chain participants (cl. 7A.11.1 (a)(iii)(C)).<sup>23</sup>
- Specifically for railway operators, Aurizon Network has requested revisions to its proposal so that Rail Industry Group membership is open to all end users, access seekers and railway operators.<sup>24</sup> This means that all railway operators, including Pacific National, will be able to receive information in relation to Aurizon Network's maintenance strategy and budget and have the opportunity to participate in good faith discussions on such matters (cl. 7A.11.3 at Appendix 1).

While Aurizon Network is not proposing railway operators have a vote on these matters,<sup>25</sup> we consider that their involvement in the development of the maintenance strategy and budget, in combination with supply chain obligations discussed above, provide railway operators additional opportunities to meaningfully engage with Aurizon Network on maintenance matters.

We note that it would not be in the interests of members of the Rail Industry Group and voting end users to agree to a maintenance strategy and budget that had a negative impact on the efficiency and performance of the supply chain.

In the situation where Aurizon Network's actual maintenance expenditure is inconsistent with any pre-approved maintenance strategy and budget, we will form a view on the prudence and efficiency of any material differences. Aurizon Network has also requested revisions to allow all stakeholders, not just members of the Rail Industry Group, to make submissions to us on the extent to which Aurizon Network's actual maintenance expenditure is inconsistent with the approved maintenance strategy and budget.<sup>26</sup> This will provide supply chain participants with the ability to participate in the consultation process if this situation occurs.

In light of the above, we do not consider that supply chain participants, such as Pacific National and the Gladstone Ports Corporation, will be worse off compared to existing arrangements.

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<sup>22</sup> This is subject to the terms of the undertaking and Aurizon Network not breaching its access agreement of safety standards.

<sup>23</sup> When viewed holistically and subject to the approved maintenance strategy and budget applicable at the time.

<sup>24</sup> Aurizon Network, Response to QCA RFI question 21, 23 July 2019, pp. 6–7.

<sup>25</sup> While Aurizon Network is proposing to include railway operators and access seekers in the Rail Industry Group, it is not proposing to assign these parties voting rights. Voting rights will be assigned to end users, based on the access rights held by each end user (see section 5.3). Response to QCA RFI question 21, 23 July 2019, pp. 6–7.

<sup>26</sup> Aurizon Network, Response to QCA RFI question 47, 23 July 2019, p. 15.

Therefore, we are currently minded to approve the proposals in relation to maintenance matters as contained in the Revised UT5 DAAU at Appendix 1.

## 1.3 Operating costs

The UT5 DAAU proposes a number of amendments to the UT5 Undertaking relating to the recovery of operating costs. Under the proposal, operating costs are classified into two discrete categories, which are treated differently:

- The Electric Operating Expenditure Allowance (EOEA), which relates to costs associated with electricity transmission and connection on the electrified parts of the CQCN.
- The Non-Electric Operating Expenditure Allowance (NEOA), which relates to all other categories of operating costs contemplated in the QCA's 2018 decision.

### 1.3.1 Non-Electric Operating Expenditure Allowance (NEOA)

#### NEOA for 1 July 2017 to 30 June 2021

A key element of the UT5 DAAU is the inclusion of fixed annual allowances for non-electric operating costs, as set out in the QCA's 2018 decision, for the period 1 July 2017 to 30 June 2021. During this period it is proposed that there be no forward-looking adjustments to Reference Tariffs for these costs (see, Schedule F, cl. 4.1(c)).<sup>27</sup>

#### NEOA for 1 July 2021 to 30 June 2023

For 2021–22 and 2022–23, the NEOA is assumed to remain fixed at the 2020–21 level, in nominal terms. However, the NEOA in these years would become subject to an asymmetric inflation adjustment mechanism under Schedule F, clause 4.3(c)(iii). Specifically, this mechanism provides for an adjustment (the NEOA Adjustment) to reflect the value of inflation on the NEOA where actual inflation for the year exceeds 2.37 per cent. In that case, the NEOA Adjustment would be calculated as the difference between the actual Consumer Price Index (CPI) inflation and 2.37 per cent, multiplied by the NEOA. The NEOA Adjustment then forms a component of the Adjusted Allowable Revenue used in setting Reference Tariffs. If actual CPI is less than 2.37 per cent, the NEOA Adjustment is deemed to be nil (Schedule F, cl. 4.3(c)(iii)).

The proposed approach to recognising differences between forecast and actual inflation is in contrast to the existing UT5 Undertaking. Under the current mechanism, Adjusted Allowable Revenues include components to reflect the impact on the operating cost allowance of any difference between the actual CPI and Wage Price Index (WPI) values in the relevant year, and the corresponding forecast CPI and WPI values used in calculating the operating expenditure used in determining reference tariffs for the relevant year. The current symmetrical approach means that customers bear the costs of higher than forecast inflation, as well as realising the benefits of lower than forecast inflation, as it affects operating costs.

The approach proposed in the DAAU would mean that, between 1 July 2017 and 30 June 2021, Aurizon Network bears all inflation risk on its non-electric operating costs where actual inflation exceeds the forecast inflation. It would also retain any savings where actual inflation is less than forecast. The commencement of the proposed CPI adjustment mechanism in 2021–22, caps the

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<sup>27</sup> Some adjustments may be available under relevant existing provisions of Schedule F cl. 4.3(c) and cl. 5.2 (Endorsed Variation Events), to the extent these represent operating costs.

risk of higher than forecast inflation for Aurizon Network while allowing it to retain savings where actual inflation is less than forecast.

#### NEOA from 1 July 2023

The UT5 DAAU proposes to 'lock-in' the NEOA for the period 1 July 2017 to 30 June 2021, at levels consistent with the QCA's 2018 decision on non-electric operating costs. These costs would then be subject to a conditional inflation adjustment mechanism from July 2021, and updated for the Reset Period which spans the period 1 July 2023 to 30 June 2027.

#### Reset Schedule F Preliminary Values

Before 31 July 2022, Aurizon Network proposes to submit preliminary updated revisions to Schedule F values. These are known as the Reset Schedule F Preliminary Values (section 1.8). These values must include NEOA (cl. 6A.2(b)(iv)).

As defined in Part 12, the NEOA for the purposes of the Reset Schedule F Preliminary Values (cl. 6A.2(b)(iv)), is the NEOA used in calculating Reference Tariffs and Allowable Revenues for the Year ending 30 June 2022.

#### Reset Schedule F Values

Prior to 31 July 2023, Aurizon Network proposes to submit revised Schedule F values known as the Reset Schedule F Values (section 1.8). As defined in Part 12, the NEOA from 1 July 2023 onwards (the Schedule F Reset Values) would reflect the NEOA used in calculating Reference Tariffs and Allowable Revenues for the Year 30 June 2023 (see cl. 6A.5(b)(i)(D)).

For the purposes of Schedule K, the NEOA for each year for the period 1 July 2023 to 30 June 2027 will reflect the NEOA used in calculating reference Tariffs for the Year commencing 1 July 2023 (see, Schedule F, cl. 4.1(h)(ii)).

### 1.3.2 Electric Operating Expenditure Allowance (EOEA)

Aurizon Network's proposal introduces the defined term 'Electric Operating Expenditure Allowance', which reflects the costs of electricity transmission and connection costs. The UT5 DAAU includes two proposed changes that are relevant to the treatment of these costs:

- Including a new clause at Schedule F, clause 5.2(d) which allows for any change in EOEA to be treated as an Endorsed Variation Event. During the period 1 July 2017 to 30 June 2023, any Reference Tariff adjustments relating to EOEA amounts are proposed to be treated as an Endorsed Variation Event under Schedule F, clause 4.1(c)(ii).
- Inclusion of updated EOEA forecasts for the Reset Period (1 July 2023 to 30 June 2027).

#### Adjustments to EOEA

Schedule K of the UT5 DAAU includes EOEA amounts for 2017–18 through to 2020–21 which are largely consistent with the values included in the QCA's 2018 Decision. For 2021–22 and 2022–23, the DAAU includes EOEA amounts that reflect the forecast allowance for 2020–21.

In establishing the allowable revenue component of Reset Schedule F Values, clause 6A.3(c) contemplates that Aurizon Network would submit updated forecasts of EOEA for the Reset Period (1 July 2023 to 30 June 2027).

Aurizon Network's proposal retains the same general approach to recovery of electric operating costs as the existing UT5 Undertaking. That is, *ex ante* forecasts are established, which are subject to reconciliation and adjustment over the period of the undertaking such that actual costs are passed through to customers. The proposal would provide two separate mechanisms for the adjustment of EOEA, as described below.

### **Ex post reconciliation**

Firstly, the DAAU retains the existing Schedule F, clause 4.3(c)(iv) which provides for an adjustment to Allowable Revenues to reflect differences between forecast and actual costs associated with connection to the electricity transmission and distribution networks.

Aurizon Network has confirmed that its intention is for this clause to continue to apply to the transmission and connection costs now defined as EOEAs.<sup>28</sup>

### **Endorsed Variation Events**

Secondly, under the existing UT5 Undertaking provisions, changes in electricity transmission, distribution and connection costs are recognised as an Endorsed Variation Event. This provision is available to Aurizon Network where the change in costs would result in a change in the AT5 Reference Tariff component of greater than 2.5 per cent (Schedule F, cl. 5.2(b)). This clause is retained in Aurizon Network's proposal and is supplemented by a new proposed clause 5.2(d). The proposed new clause 5.2(d) appears to cover the same types of costs, however qualification as an Endorsed Variation Event would not be subject to a materiality threshold unlike clause 5.2(b).

Aurizon Network has clarified that it is seeking to delete the proposed clause 5.2(d) and amend the start of clause 5.2(b) to specifically include 'any change in the Electric Operating Expenditure Allowance as contemplated in clause 4.1(c)(ii) including.....'.<sup>29</sup> This requested revision would ensure that the existing review event criteria at clause 5.2(b), including the materiality threshold, apply to the EOEAs. This revision would only reflect the updated terminology used to describe these electric costs, and not affect the mechanism or criteria relevant to the review event process.

### **1.3.3 QCA analysis and preliminary position**

Stakeholders did not comment on the proposed treatment of operating expenditure allowances in the UT5 DAAU.

We are minded to approve the proposed treatment of non-electric operating costs set out in the Revised UT5 DAAU at Appendix 1. Relevantly, the proposed approach introduces some improved incentives for Aurizon Network to realise operating expenditure efficiencies, and to reveal efficient operating costs over time.

The proposed treatment of the electric operating costs appears appropriate and largely consistent with the existing UT5 Undertaking approach to dealing with changes in transmission and connection costs. On this basis, we are minded to approve the amendments as outlined in the Revised UT5 DAAU at Appendix 1.

## **1.4 Asset replacement and renewals**

Part 7A.11 of Aurizon Network's UT5 DAAU proposal outlines a new process for assessing and approving Aurizon Network's asset replacement and renewal costs. Operational costs associated with ballast undercutting activities will be considered through this process.

Aurizon Network's proposal also includes an obligation to require Aurizon Network to fund all asset replacement and renewal expenditure necessary to deliver committed capacity. This

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<sup>28</sup> Aurizon Network, Response to QCA RFI question 10, 1 August 2019, pp. 6–7.

<sup>29</sup> Aurizon Network, Response to QCA RFI question 10, 1 August 2019, pp. 6–7.

requirement is subject to both the renewals and maintenance strategies and budgets in place and any variations to the relevant budget and strategy permitted through the UT5 DAAU proposal (cl. 7A.11.7).

#### 1.4.1 Pre-approval of a renewals strategy and budget

Consistent with the assessment and approval of maintenance costs, Aurizon Network's proposal provides a process to approve a renewals strategy and budget on an *ex-ante* basis. This renewals strategy and budget must include:

- the scope of work with key deliverables and an indicative timetable;
- a budget for the scope of work;
- the practices, procurement strategies and methodology to be applied; and
- a description of the impact on coal systems, supply chains and forecast throughput.

From 2020–21, Aurizon Network must provide a draft of its renewals strategy and budget to the Rail Industry Group and non-coal access holders and customers<sup>30</sup> and engage with its members on related matters, before voting end users decide whether they will approve the strategy and budget (cl. 7A.11.3). The Revised UT5 DAAU specifies that a special majority of end users may appoint an expert advisor who may attend meetings and discussions between Aurizon Network and members of the Rail Industry Group and consider confidential information in relation to Aurizon Network's draft Renewals Strategy and Budget (cl. 7A.11.3). Where Aurizon Network and end users do not reach agreement, Aurizon Network's draft renewals strategy and budget will be implemented. This differs to the proposed maintenance obligations as there is no requirement for QCA involvement.

Asset replacement and renewal costs consistent with the approved renewals strategy and budget will be included in the allowable revenue, through the capital indicator (cl. 7A.11.4).

#### 1.4.2 Assessment of actual asset replacement and renewals expenditure

Consistent with the existing UT5 Undertaking, Aurizon Network must submit its capital expenditure for assessment and approval through Schedule E in 2017–18 and 2018–19. However, from 2019–20, proposed obligations in Part 7A.11 require Aurizon Network to separately submit its actual asset replacement and renewals expenditure, along with the scope of work completed, procurement strategy applied and methodology used (cl. 7A.11.6 (a)). In 2019–20 these costs will continue to be assessed and approved through Schedule E.<sup>31</sup>

From 2020–21, where there is an approved renewals strategy and budget in place, Aurizon Network has clarified that actual renewals expenditure consistent with the approved strategy and budget must be accepted by the QCA and will not require approval through Schedule E.<sup>32</sup> However, where actual expenditure is inconsistent with the approved renewals strategy and budget, or no approved strategy and budget exists, the QCA will continue to assess the prudence and efficiency of the costs, consistent with the process in clause 2 of Schedule E.<sup>33, 34</sup>

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<sup>30</sup> Aurizon Network, Response to QCA RFI question 44, 23 July 2019, p. 14.

<sup>31</sup> This process has been confirmed by Aurizon Network. Aurizon Network, Response to QCA RFI question 50, 23 July 2019, p. 15.

<sup>32</sup> Aurizon Network, Response to QCA RFI question 51, 23 July 2019, pp. 15–16.

<sup>33</sup> Aurizon Network, Response to QCA RFI question 3, 9 August 2019, p. 3.

Allowable Revenues and Reference Tariffs will be adjusted to reflect the QCA's decision on Aurizon Network's actual asset replacement and renewals expenditure. This will occur through obligations in Schedule E and F that provide for adjustments to reflect differences between the capital indicator and the QCA approved capital expenditure (Schedule E, cl. 5(b); Schedule F, cl. 4.1 (a)(ii)).

### 1.4.3 QCA analysis and preliminary position

We consider the process for assessment and approval of asset replacement and renewal costs reasonable, and are currently minded to approve the obligations in the Revised UT5 DAAU at Appendix 1.

We note that the proposed process is similar to the current assessment and approval of asset replacement and renewal costs, whereby Aurizon Network submits these costs to us through the capital indicator, and costs are then subject to an *ex-post* assessment. The key difference is that Aurizon Network is guaranteed to recover costs that are consistent with the approved renewals strategy and budget. We consider this reasonable, noting that end users must support the strategy and budget for it to receive approval.

Pacific National submitted that all supply chain participants should be given the option to participate in decision making processes pertaining to asset replacement and renewals.<sup>35</sup>

Aurizon Network is not required to consult with supply chain participants on its renewals strategy and budget under the existing UT5 Undertaking. In addition, we have not previously determined the renewals strategy and budget to apply. Rather, we approved a capital indicator allowance, which was not included in the regulatory asset base until an *ex-post* assessment of capital expenditure was completed.

Aurizon Network has requested revisions to its proposal so that railway operators, such as Pacific National have the option to become members of the Rail Industry Group.<sup>36</sup> This will allow railway operators to receive information and participate in discussions related to the renewals strategy and budget.

Aurizon Network's UT5 DAAU proposal also includes a number of supply chain obligations that broadly require Aurizon Network to coordinate with other supply chain participants. These are discussed in detail in section 1.2.4 with regard to supply chain participation in maintenance matters.

For the situation where the Aurizon Network's actual expenditure is different to the approved renewals strategy and budget, Aurizon Network has requested revisions to its proposal that will allow all stakeholders to make submissions on inconsistencies.<sup>37</sup> We will consider such submissions in forming a view on whether actual expenditure is prudent and efficient.

Given the above, we consider that supply chain participants will not be worse off compared to existing arrangements.

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<sup>34</sup> Aurizon Network has clarified that only costs in addition to the approved strategy and budget should be assessed in accordance with Schedule E. Where a renewals capex claim is less than the approved renewals strategy and budget, these costs will be approved in accordance with cl. 7A.11.6(b)(iii). Aurizon Network, Response to QCA RFI question 3, 9 August 2019, p. 3.

<sup>35</sup> Pacific National, sub. 22: 3.

<sup>36</sup> Aurizon Network, Response to QCA RFI question 21, 23 July 2019, pp. 6–7.

<sup>37</sup> Aurizon Network, Response to QCA RFI question 48, 23 July 2019, p.15.



#### 1.4.4 Treatment of ballast undercutting costs

The QCA's 2018 Decision required all ballast undercutting costs be treated as capital expenditure from 2019–20 onwards.

Aurizon Network has proposed that only operational ballast undercutting costs should be capitalised. As such, maintenance costs in the reference tariffs and allowable revenues of the UT5 DAAU proposal (Schedule F and Schedule K) include return on capital and return of capital (depreciation) costs associated with ballast undercutting plant.

Aurizon Network's proposed treatment of ballast undercutting costs would provide for these to be assessed and approved under a range of different processes:

- Operational costs — these are asset replacement and renewal costs, assessed and approved through clauses 7A.11.3 and 7A.11.6 of the UT5 DAAU proposal.<sup>38</sup>
- Depreciation costs — these are direct maintenance costs, assessed and approved through clauses 7A.11.3 and 7A.11.5 of the UT5 DAAU proposal.
- Return on capital costs — these are indirect maintenance costs, assessed and approved through clause 6A of the UT5 DAAU proposal.

The forecast cost base from which the return on capital and depreciation costs are derived will be assessed through clause 6A of the UT5 DAAU proposal.

#### 1.4.5 QCA analysis and preliminary position

We are currently minded to approve Aurizon Network's proposed treatment of ballast undercutting costs.

We note that Aurizon Network's approach is not inconsistent with the QCA's 2018 Decision in that it aligns with Aurizon Network's group capitalisation policy. Operational costs that have characteristics consistent with renewals expenditure will continue to be capitalised.

Depreciation costs will be captured under the proposed maintenance processes outlined in Part 7A.11. Aurizon Network has requested revisions so that the definition of maintenance strategy and budget reflects the inclusion of depreciation costs associated with ballast undercutting plant.<sup>39</sup> Under the proposed arrangements for ballast cleaning:

- End users have the opportunity to support inclusion of depreciation costs associated with maintenance plant and equipment if they consider this necessary to deliver the strategy or budget.
- End users have the opportunity to not support inclusion of depreciation costs associated with maintenance plant and equipment if they do not consider this necessary to deliver the strategy or budget.
- Where pre-approval is not obtained from end users, the QCA could determine the maintenance strategy and budget forming views on depreciation costs associated with maintenance plant and equipment considered necessary.

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<sup>38</sup> Ground penetrating radar measurement costs that have been prudently and efficiently incurred and are not recoverable elsewhere in the Undertaking will be recoverable through Schedule F and as such will not be capitalised (Schedule F, cl.4.3 (c)(vii)).

<sup>39</sup> Aurizon Network, Response to QCA RFI question 42, 23 July 2019, p.13.



Under any situation, even though these costs will be expensed, they will be subject to an *ex-post* prudence and efficiency assessment by the QCA if the costs are inconsistent with the approved strategy and budget. This would be expected to present Aurizon Network with appropriate incentives to incur efficient costs and provide sound justification for its overall ballast undercutting costs.

While the return on plant will be treated as an indirect maintenance cost in Aurizon Network's proposal, the cost base from which these costs are derived will be assessed by the QCA (see cl. 6A). Through this assessment, the QCA would assess what plant and equipment was required. As such, we consider that Aurizon Network is incentivised to only incur efficient investment in maintenance plant.

With regard to the value of costs included in the direct and indirect maintenance allowances in Schedule K, Aurizon Network has clarified that costs up to and including 2020–21 are consistent with the return on capital and depreciation costs assessed and approved by the QCA in the 2018 Decision. The costs in 2021–22 and 2022–23 are derived from the QCA amount in 2020–21.<sup>40</sup> This has been confirmed through the financial models provided. As such, we are currently minded to accept the ballast undercutting costs included in Schedule K of the Revised UT5 DAAU. We note that these costs may be subject to various adjustments as outlined in the Revised UT5 DAAU.

## 1.5 Approved WACC

The UT5 DAAU proposes an Approved WACC of:

- 5.7 per cent to apply from 1 July 2017 to 3 May 2019.<sup>41</sup>
- At least 5.9 per cent to apply from 3 May 2019 to 30 June 2023.<sup>42</sup>
- A Reset WACC that applies from 1 July 2023 until the UT5 Undertaking terminates (see section 1.8), which is based on adjusting the Approved WACC taking into account the:
  - Reset Risk Free Rate Difference<sup>43</sup> — being the difference from 1.90 per cent and the average of the Risk Free Rate at the close of business on each of the 20 Business Days up to (and including) 30 June 2023, using the rate for Commonwealth of Australia Government nominal bonds using the RBA indicative mid-rate with a term of four years, estimated using methodologies consistent with those applied by the QCA in the development of the rate of 1.9% as set out in Appendix F of the QCA's Final Decision;<sup>44</sup> and
  - Reset Debt Risk Premium Difference<sup>45</sup> — being the difference from 2.04 per cent and the forecast calculated with reference to the methodology referred to in Appendix F of the QCA's 2018 Decision (including the simple portfolio econometric estimation methodology (PwC methodology)) for BBB+ rated corporate bonds for the four year period, using criteria consistent with that adopted to calculate the debt risk premium in the QCA's

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<sup>40</sup> Aurizon Network, Response to QCA RFI question 43, 23 July 2019, p. 13.

<sup>41</sup> Refer to proposed definition of Approved WACC.

<sup>42</sup> Refer to proposed definition of Approved WACC.

<sup>43</sup> Refer to proposed definitions of Reset Risk Free Rate Difference; Reset Risk Free Rate; and Risk Free Rate.

<sup>44</sup> QCA's 2018 Decision

<sup>45</sup> Refer to proposed definitions of Reset Debt Risk Premium Difference; and Reset Debt Risk Premium.

2018 Decision, and using an average over the 20 Business Day period up to (and including) 30 June 2023, at 55 per cent gearing.

- An increase to the Approved WACC of 0.4 per cent to apply from the date on which:
  - the Independent Expert provides its Initial Capacity Assessment Report when no network capacity deficit is identified; or
  - Aurizon Network responds with options to address network capacity deficits identified in Initial Capacity Assessment Report.<sup>46</sup>
- A decrease of 0.3 per cent to apply where the rebate mechanism no longer applies (cls. 7A.6(k)-(n)). This occurs where the QCA's review of the Rebate Objectives (cl. 7A.6(g)) finds these objectives have not been met in a material way and Aurizon Network does not submit:
  - amendments required by the QCA; or
  - alternative arrangements agreed with by a majority of end users.

Aurizon Network has also submitted amendments to the calculation of adjusted allowable revenue, where the Approved WACC is different from that used to determine reference tariffs (Schedule F, 4.3(c(i))).

### QCA analysis and preliminary position

We are currently minded to approve the proposed rate of return provisions set out in the Revised UT5 DAAU. Relevantly, we note that a diverse and overwhelming number of coal producers have supported the package of proposed amendments and by doing so have made their own assessment of the commercial and regulatory risks that will affect Aurizon Network under the proposed UT5 DAAU arrangements as well as the benefits and costs that these provisions are expected to provide.

We note that the objective of setting the Reset WACC that applies from 1 July 2023 is to establish the required variations to reflect the differential between the debt risk premium and risk free rate calculated by applying the same methodology outlined in the QCA's 2018 Decision, Appendix F. While we do not consider that these methods represent our preferred approach to these matters, we approve the mechanistic approach to calculate the Reset WACC.

Given the consensus position of the parties with respect to various components of the WACC, we consider that it is not necessary to investigate these matters. Aurizon Network submitted that in relation to the proposed WACC variations, coal producers have supported the UT5 DAAU and agreed that the proposed Approved WACC provisions include the value, cost and regulatory and commercial risks to Aurizon Network associated with all of the various enhanced operational and performance improvements contained in the UT5 DAAU.<sup>47</sup>

## 1.6 Annual capital expenditure reconciliation

Aurizon Network has proposed amendments that provide for an annual reconciliation of capital expenditure (Schedule E, 5 — Capital expenditure reconciliation). These amendments provide for a Capital Expenditure Allowable Revenue Adjustment, which amongst other things, takes

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<sup>46</sup> See proposed definition of Approved WACC, UT5 Revised DAAU at Appendix 1.

<sup>47</sup> Aurizon Network, sub. 1: 13.

into account differences between forecast and actual capital expenditure in terms of depreciation, return on capital, and tax depreciation (Schedule E, 5(b)(i)-(iii)).

The Capital Expenditure Allowable Revenue Adjustment is proposed to be incorporated within the Allowable Revenues in the year following the QCA's approval of capital expenditure (Schedule E, 5(b)). This provides for an annual true-up process within the annual review of reference tariffs (Schedule F, 4.1(a)(ii)).

### QCA analysis and preliminary position

We are currently minded to approve the proposed annual reconciliation of capital expenditure set out in the Revised UT5 DAAU at Appendix 1.

Stakeholders did not raise any concerns with this proposed provision in submissions.

While this process will be undertaken on a more frequent basis, annually rather than at the commencement of a new regulatory period, the calculation process itself is consistent with existing UT5 Undertaking arrangements.

## 1.7 Tax allowance annual review update

Aurizon Network has proposed amendments that permit from 1 July 2018, incorporating any differences between the proposed and forecast tax allowance, within the annual review of reference tariffs (Schedule F, 4.1(b)(vii)(F)). These provisions rely on the application of a defined term 'Gamma' at 0.484 being the adjustment to tax allowance for the value of dividend imputation credits.

### QCA analysis and preliminary position

We are currently minded to approve the proposed tax allowance annual review update set out in the Revised UT5 DAAU at Appendix 1.

Stakeholders did not raise any concerns with this proposed provision in submissions.

Aurizon Network stated that where allowable revenues are updated via the annual review processes the impact on tax allowances can now be included. For example, any variation of the Capital Indicator under Schedule F, clause 4.1 (b)(vii)(E) arising from the Asset Renewals Strategy and Budget would have a direct impact on the tax allowance.<sup>48</sup>

## 1.8 Extension of Schedule F values - Reset period (Part 6A)

Schedule F of Aurizon Network's UT5 DAAU sets out reference tariffs for coal carrying train services, and where applicable, the calculated premium/discount, as well as the system gtk forecasts and allowable revenues for 2017–18 to 2022–23.<sup>49</sup>

Part 6A of the UT5 DAAU sets out how reference tariffs (allowable revenues and gtk forecasts) are established and applied for the period from 2023–24 to 2026–2027 (the Reset Period).

Aurizon Network must submit its preliminary revisions to Schedule F for each of the years in the reset period to the QCA by 31 July 2022 (Reset Schedule F Preliminary Values).

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<sup>48</sup> Aurizon Network, Response to QCA RFI question 88, 23 July, p. 1.

<sup>49</sup> See the following clauses: the Blackwater System reference tariffs, cls. 7.2–7.3; the Goonyella System reference tariffs, cls. 8.2–8.3; the Moura System reference tariffs, cls. 9.2–9.3; the Newlands System reference tariffs, cls. 10.2–10.3; the Goonyella to Abbot Point System reference tariffs, cls. 11.2–11.3.

- The allowable revenue components are developed only using specified inputs, which will be preliminary for some inputs (cl. 6A.3).<sup>50</sup>
- The reference tariff components are developed using the inputs to the allowable revenue components, gtk forecasts, various system premiums, system discounts and expansion tariffs, and cost allocations between systems (cl. 6A.4).

Aurizon Network must submit revisions to the Reset Schedule F Preliminary Values to reflect updates to various inputs<sup>51</sup> by 31 July 2023 (Reset Schedule F Values) (cl. 6A.5(b)).

The QCA will consider, and if applicable, approve revisions to Schedule F. Clauses 6A.6 and 6A.7 provide a process for approval that is designed to enhance transparency and confidence in the Schedule F components. This includes:

- requiring Aurizon Network to provide the QCA with supporting documents, assumptions, modelling and calculations used (cl. 6A.6)
- providing for the QCA to publish the proposed revisions<sup>52</sup> and supporting documentation<sup>53</sup> and invite submissions; providing clear guidance around the matters the QCA is to take into account (including the treatment of various inputs) and setting out a process should the QCA refuse to approve the proposed revisions.

Allowable revenues are proposed to be adjusted to reflect the differences between the Preliminary Limited Inputs and the Limited Update Inputs (Schedule F, (4.3(ca))).

In the event that a third party index or rate required to calculate any of the inputs is no longer published, Aurizon Network and end users will propose the most appropriate alternative index or rate to the QCA (see cl. 6A.6(b)).

### QCA analysis and preliminary position

We are currently minded to approve the proposed amendments that provide for the extension of Schedule F values for the Reset Period as set out in the Revised UT5 DAAU. Relevantly, we note that a diverse and overwhelming number of coal producers have supported the package of proposed amendments. We note that these provisions provide regulatory certainty to Aurizon Network and coal producers (access seekers/holders) as to the calculation of reference tariffs and allowable revenues in future years.

We also note that the Revised UT5 DAAU expressly contemplates that Aurizon Network must provide supporting documents, modelling and assumptions used in the revised data and forecasts for us to consider. Part 6A also provides that we will publish proposed reset values on which it will seek and consider submissions from industry participants, as part of the process of approving or refusing to approve the proposed reset values by which the Reference Tariffs will be revised. In this regard, we are able to make a decision as to whether the values have been correctly calculated. For example, Aurizon Network has confirmed that if a bond within the sample is inconsistent with the selection criteria outlined in the QCA's 2018 Decision, then the

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<sup>50</sup> The UT5 DAAU sets out how the preliminary inputs are to be calculated for: the Reset WACC; the Reset Inflation rate (cl. 6A.2(b)).

<sup>51</sup> Updates will be required for: the risk free rate; the inflation rate; the debt risk premium; and the tax allowance.

<sup>52</sup> Being the Reset Schedule F Preliminary Values and the Reset Schedule F Values.

<sup>53</sup> Subject to confidentiality restrictions.

debt risk premium will not have been correctly calculated and we can refuse to approve this input.<sup>54</sup>

We note that the following inputs, (listed in cl. 6A.1(c)) will be developed using the same methodology as was approved in our 2018 Decision and only reflect updated values:

- a revision of the Risk Free Rate;
- a revision of the inflation rate;<sup>55</sup>
- a revision of the Debt Risk Premium; and
- calculation of Tax Allowance.

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<sup>54</sup> Aurizon Network, Response to QCA RFI question 4, 9 August, pp. 4–5.

<sup>55</sup> The Reset Inflation Rate is a forecast inflation rate for the Reset Period calculated as the arithmetic average of the midpoint of short-term Reserve Bank of Australia inflation rate forecasts for the period from 1 July 2023 to the period that the RBA reports short-term inflation forecasts and the midpoint of the RBA target band for inflation for the years to the Terminating Date (if any) that short-term RBA inflation rate forecasts are not available.

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## 2 AMENDMENTS TO PART 7A: CAPACITY

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Aurizon Network proposes a number of amendments to the assessment of capacity as outlined in Part 7A. These include obligations in relation to the appointment of an Independent Expert who, amongst other things, will perform the capacity assessments outlined in Part 7A, along with a rebate mechanism and supply chain obligations. Various amendments are also proposed to Schedule G, including the insertion of capability train plan principles.

### 2.1 Independent Expert

Aurizon Network has proposed the appointment of an Independent Expert to undertake a range of different capacity assessments and other duties under the undertaking that were either previously performed by Aurizon Network or are proposed new additions to the undertaking. These roles are explicitly listed within the UT5 DAAU and do not include statutory functions of the QCA. The roles include:

- the carrying out of annual capacity assessments, including determining whether there are existing capacity deficits in coal systems
- developing and reviewing system operating parameters
- administering a rebate scheme for end users for non-performance arising from Aurizon Network breaching particular obligations
- assessing completed expansions to determine whether an expansion capacity deficit exists (under Part 8)
- making recommendations on transitional arrangements to resolve an existing capacity deficit in particular circumstances
- determining end user voting rights for each end user
- confirming there is capacity to deliver access rights requested by an access seeker, including various tasks to assess whether a proposed expansion will deliver required capacity
- reviewing and approving the efficiency and prudence of a proposed expansion to address an existing capacity deficit or expansion capacity deficit
- reporting on Aurizon Network's performance (under Part 10).

In the first instance, the Independent Expert can be jointly appointed by Aurizon Network and a majority of end users.<sup>56</sup> The QCA has a clear role to undertake the appointment of the Independent Expert if Aurizon Network and end users cannot reach agreement (cl. 7A.3). The Independent Expert must meet certain requirements to be appointed, including being independent and impartial, engaging personnel with appropriate qualifications and practical experience, having no interest or duty that would conflict with the appointment, and being required to manage confidential information (cl. 7A.3.1(e)).

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<sup>56</sup> This is defined as being a number of end users that in aggregate hold at least 60% of the end user voting rights or, if not satisfied, at least 50% of voting users and a number of end users that, in aggregate, hold at least 50% of the end user voting rights. Voting rights are determined by the highest volume of contracted access rights that an end user has over a five-year forecast period.

The Independent Expert is intended to be appointed until the end of the proposed extended term of the undertaking (i.e. 30 June 2027), although there is scope for the appointment to be terminated earlier, including following a QCA review of the Independent Expert's appointment after four years (cl. 7A.3.3).<sup>57</sup>

The costs of engaging the Independent Expert are to be a pass through cost recoverable as a component of the reference tariff by which access charges are calculated.<sup>58</sup> Aurizon Network said this clause is meant to capture all costs charged by the Independent Expert in performing all of its functions under the undertaking, including capacity assessments, reporting and assessments of rebates.<sup>59</sup> Aurizon Network also said that, non-coal access holders will not be required to contribute to the costs of the Independent Expert.<sup>60</sup>

### QCA analysis and preliminary position

We are minded to approve the arrangements for the Independent Expert as outlined in the Revised UT5 DAAU at Appendix 1.

We acknowledge that it is the proposal of Aurizon Network, and a diverse and overwhelming number of coal producers that negotiated the development of Aurizon Network's UT5 DAAU, for an Independent Expert to become responsible for the various proposed matters set out under the DAAU, including capacity modelling and assessments currently undertaken by Aurizon Network. We do not consider it inappropriate for the Independent Expert to be responsible for these matters, as there are appropriate arrangements in the undertaking to ensure the Independent Expert is well-placed to perform its functions appropriately and effectively. On this point, we note Aurizon Network's proposal includes requirements for, among other things, the Independent Expert to be suitably qualified and experienced, impartial and independent, and required to handle confidential information. There are also requirements for Aurizon Network to provide relevant information to the Independent Expert to assist in the performance of its functions (see, for example, cl. 7A.4.1(d) in respect of the Initial Capacity Assessment).

Pacific National proposed Aurizon Network's UT5 DAAU be amended so that all supply chain participants be provided with the opportunity to be involved in the development of the scope, constitution and governance arrangements that will apply to the Independent Expert during the term of the UT5 DAAU.<sup>61</sup> We are not convinced that Aurizon Network's proposal must be amended so that all supply chain participants are involved in the setting up of the Independent Expert's appointment.

We consider Aurizon Network's proposal contains sufficient safeguards for the governance arrangements that will ultimately apply to the Independent Expert. For example, Aurizon Network's proposal includes general requirements for the Independent Expert in respect of conflicts of interest, including a continuing duty on the Independent Expert to disclose to the QCA any circumstances that might be considered to adversely affect the Independent Expert's ability to act independently and impartially. Stakeholders also have the ability to notify the QCA

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<sup>57</sup> Following this review, Aurizon Network and a special majority of end users may agree, or the QCA may, in its absolute discretion, terminate the engagement of the Independent Expert (see cl. 7A.3.3 of the Revised UT5 DAAU).

<sup>58</sup> Aurizon Network, Response to QCA RFI question 1, 17 September 2019, p. 1; cl. 7A.3.4 of the Revised UT5 DAAU.

<sup>59</sup> Aurizon Network, Response to QCA RFI question 22, 23 July 2019, p. 7.

<sup>60</sup> Aurizon Network, Response to QCA RFI question 22, 23 July 2019, p. 7.

<sup>61</sup> Pacific National, sub. 22: 3.

of any such circumstances they believe exist, which enables the QCA to investigate the matter and potentially terminate the appointment of the Independent Expert (cl. 7A.3.3(e)). Further, there is also a requirement for the Independent Expert to manage confidential information that it receives in the performance of its duties, including entering into a confidentiality agreement with persons providing information to the Independent Expert (cl. 7A.3.1(e)(iv)). We consider Aurizon Network's ringfencing obligations in regard to the disclosure of confidential information to third parties would also apply to information it discloses to the Independent Expert (cl. 3.11(a)).

New Hope Group also commented on the setting up of the Independent Expert. It expressed concern about whether the costs associated with the setting up and operation of the Independent Expert will be efficient and whether such costs would be equitably distributed among users.<sup>62</sup>

Aurizon Network proposes that the costs of the Independent Expert are to be recovered as a separate reference tariff component. Inclusion of the Independent Expert's costs in this way means these costs will be levied on a net tonne basis as a component of access charges, meaning that larger scale users will ultimately end up paying a larger amount of the costs, given their larger volumes. We also consider that end users will be incentivised to seek efficiency in the costs of the Independent Expert, given they will ultimately be paying these costs through access charges. Overall, we consider these arrangements are appropriate to approve.

Aurizon Network has requested revisions to include a new clause 7A.3.5 to determine whether the threshold of a majority of end users has been reached for appointing the Independent Expert, given voting rights would be a matter for the Independent Expert to determine. Aurizon Network is proposed to determine this matter.<sup>63</sup> We are minded to approve this requested revision as set out in the Revised UT5 DAAU at Appendix 1.

On the appointment of the Independent Expert, Aurizon Network has requested revisions to its UT5 DAAU that remove the requirement for the QCA to jointly appoint the Independent Expert with Aurizon Network and a majority of end users. Instead, the QCA is proposed to only appoint the Independent Expert if Aurizon Network and a majority of end users cannot agree an appointment (cl. 7A.3.1(d)).<sup>64</sup>

We are not convinced that it is appropriate for us to directly appoint the Independent Expert, where the parties cannot agree. It is the interests of Aurizon Network and end users to make this appointment, given the functions and operating environment of the Independent Expert.

That said, we accept that we have a role where the parties cannot agree on the appointment — but do not necessarily accept this extends to ongoing contractual engagement with the Independent Expert. In these hopefully unlikely and unusual circumstances, the existing dispute resolution provisions (Part 11) are well placed to progress this matter where the disagreeing parties bring this matter to the QCA.

Amendments are presented in the Revised UT5 DAAU at Appendix 1 to reflect our preliminary views on this matter. We welcome stakeholder views on this matter.

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<sup>62</sup> New Hope Group, sub. 23: 2.

<sup>63</sup> Aurizon Network, Response to QCA RFI question 1, 1 August, p. 1.

<sup>64</sup> Aurizon Network requested revisions to clarify the QCA's appointment of the Independent Expert would be without prejudice to the QCA performing any of its functions in the undertaking.



## 2.2 Capacity assessments to be undertaken by the Independent Expert

Aurizon Network's proposal includes arrangements for the Independent Expert to carry out the following capacity assessments under Part 7A of the DAU:

- an annual capacity assessment, which will assess the deliverable network capacity of each coal system. Each successive assessment will be used by Aurizon Network when it is required to have regard to capacity when performing its obligations under the undertaking. The first of these assessments (the initial capacity assessment) will include an assessment of whether there is an 'existing capacity deficit' in a coal system
- a system capacity assessment to be carried out each year. These assessments have a focus on the capacity impacts of the different elements of the supply chain and are to be used for information purposes only.

### 2.2.1 Initial capacity assessment and annual capacity assessments

The initial capacity assessment is to be the Independent Expert's initial assessment of the deliverable network capacity of each coal system (cl. 7A.4.1). The term 'Deliverable Network Capacity' is defined in clause 7A.2 and focuses on the capacity of the rail infrastructure, expressed as the maximum number of train paths that can be utilised in each coal system, taking into account the operation of that coal system, having regard to various listed factors, such as allowances for reasonable planned and unplanned maintenance, and interfaces with other elements of the supply chain.

The initial capacity assessment will include capacity modelling, development of system operating parameters for each coal system, reporting on constraints that have been identified as reducing or likely to reduce deliverable network capacity and details of any existing capacity deficit (i.e. where deliverable network capacity of a coal system is less than the number of train paths required to meet train service entitlements) (cl. 7A.4.1(f)). Aurizon Network has obligations in respect of an existing capacity deficit identified by the Independent Expert (discussed further below).

As part of the initial capacity assessment, the Independent Expert must develop the system operating parameters for each coal system, having regard to the way in which each coal system operates in practice (cl. 7A.4.1(b)). This is to replace the existing process for the setting of system operating parameters by Aurizon Network (cl. 7A.9). The system operating parameters to be developed by the Independent Expert cannot place Aurizon Network in breach of its obligations under the undertaking or an access agreement, although there is a mechanism for an access holder or end user to require Aurizon Network to make amendments to an access agreement that are consistent with and reflect system operating parameters as determined by the Independent Expert (cl. 7A.12).

In subsequent years, the Independent Expert must carry out an annual capacity assessment, which will cover the same matters as the initial capacity assessment, including reviewing and potentially amending the system operating parameters, although the arrangements relating to existing capacity deficits are limited to the initial capacity assessment only (cl. 7A.4.2).

The initial (and annual) capacity assessment is to be made available to Aurizon Network and the QCA on an unredacted basis, and a redacted version that excises confidential information will be published (cl. 7A.4.1(g)-(i)). The Independent Expert's capacity assessment is final and binding, unless there is fraud or manifest error (cl. 7A.4.4).

Aurizon Network must only have regard to the most recent capacity assessment performed by the Independent Expert (and not its own internal modelling) when it is required to have regard to capacity when performing any of its obligations under the undertaking (cl. 7A.4.4(d)). This is reflected elsewhere in Aurizon Network's proposal. For example, proposed amendments to Part 4 of the undertaking (Negotiation Framework) make it necessary for Aurizon Network to obtain the advice of the Independent Expert on whether there is sufficient available capacity to provide access rights sought in an access application (cl. 4.6). Aurizon Network has also proposed that it be required to seek and have regard to the Independent Expert's view when reviewing the system rules (cl. 7A.7.4) as well as for other matters under the undertaking.

### QCA analysis and position

Pacific National expressed concern over whether supply chain participants would have a sufficient role in the Independent Expert's consultative and decision making processes, including in the development of the system operating parameters.<sup>65</sup> It also proposed Aurizon Network's UT5 DAAU be amended so that all supply chain participants be provided with the ability to refer an Independent Expert decision to the QCA for review if they have a 'genuine concern' the decision did not have appropriate regard to all of the information that was presented by the supply chain participants in the relevant decision-making process.<sup>66</sup>

We consider the Independent Expert should seek the views of train operators and other supply chain participants when undertaking its capacity assessments, as they have a legitimate interest in these matters and their views and information they can provide could be a material input into the Independent Expert's assessment. However, we consider Aurizon Network's proposal already provides for the participation of supply chain participants, including train operators, in these processes. For example, the UT5 DAAU proposal obliges the Independent Expert to consult with Aurizon Network, access holders and access seekers (and their customers and train operators, as applicable), as well as all other supply chain participants, when undertaking the capacity assessment and developing proposed system operating parameters (cl. 7A.4.1(c) and 7A.4.2(c)). The Independent Expert's capacity assessment must also include consideration of the outcomes of this consultation (cl. 7A.4.1(f)(iii) and cl. 7A.4.2(e)).

We appreciate Pacific National's concern about whether the Independent Expert will have appropriate regard to the information presented by supply chain participants. We consider that ultimately it will be a matter for the Independent Expert to demonstrate its consideration of the relevant information it has received in its assessment. There is scope for the Independent Expert's assessment to be disputed if there has been fraud or a manifest error. We are not convinced that a lower threshold to dispute the Independent Expert's assessment is necessary. We consider the proposed arrangement for the determination to be final and binding in the absence of fraud or manifest error is appropriate in this context and is similar to expert determinations in a dispute resolution process, given the technical and specialised nature of these assessments.

Our position on these matters is based on the understanding that the standard operating parameters to be developed, and reviewed and amended over time, by the Independent Expert will not change the way in which access is provided on a contractual basis, without an access holder's consent. This appears to be reflected in Aurizon Network's proposed arrangements,

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<sup>65</sup> Pacific National, sub. 22: 3–4.

<sup>66</sup> Pacific National, sub. 22: 3.

which restrict the Independent Expert from developing a system operating parameter that would place Aurizon Network in breach of an access agreement (see cl. 7A.4.1(b)) and includes a mechanism for an access holder or end user to require Aurizon Network to amend an access agreement to reflect a system operating parameter (cl. 7A.12). Relevantly, Aurizon Network said that a standard access agreement, when entered into, would reflect the then current system operating parameters as determined by the Independent Expert and that any subsequent changes to the system operating parameters could be reflected in the access agreement if the access holder requires the change through the clause 7A.12 process.<sup>67</sup> This implies that changes to the standard operating parameters will not automatically 'flow through' to access agreements and that any changes would need to be agreed to by the access holder. We seek further information from stakeholders on this point and may revise its position on these matters depending on the information received.

Pacific National also raised concern about the ability for existing access agreements and train operating deeds to be amended after the Independent Expert releases its determination on the system operating parameters (cl. 7A.12). It said it is likely that coal producers will seek to compel above-rail operators to pass through all of the changes in the operating parameters irrespective of whether these impose additional costs on above-rail operators or create inefficiencies in the operation of an above-rail business.<sup>68</sup>

We understand the arrangements in Aurizon Network's UT5 DAAU will not enable Aurizon Network or end users to compel a train operator to make changes to its operating practices due to changes in system operating practices. We note the proposed mechanism for amendments to access agreements to reflect system operating practices determined by the Independent Expert is dependent on a train operator's train operations deed also being amended in a consistent manner. Accordingly, it is our understanding that the train operator will need to consent to any changes to the contractual arrangements to reflect the system operating parameters developed by the Independent Expert.

### 2.2.2 Existing capacity deficit

Aurizon Network's UT5 DAAU includes a process that will apply if the Independent Expert's initial capacity assessment reveals an existing capacity deficit in a coal system (cl. 7A.5).

If this occurs, Aurizon Network must publish on its website and provide the QCA its preliminary report setting out, among other things, Aurizon Network's preliminary views on the cause of any existing capacity deficit and solutions which could most effectively and efficiently address the deficit (cl. 7A.5(a)(i)). Aurizon Network must then consult with end users, customers and access holders of the relevant coal system, as well as train operators, to identify and consider any 'transitional arrangements' which could effectively and efficiently address the existing capacity deficit, or whether affected access holders and customers would prefer not to do anything to address the existing capacity deficit (cl. 7A.5(a)(ii)). Specifically, these transitional arrangements are:

- whether changes can be made to certain practices, such as the operation and maintenance practices for the rail infrastructure, the operation of rollingstock by railway operators and the operation and maintenance practices in respect of load-out facilities

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<sup>67</sup> Aurizon Network, Response to QCA RFI question 23, 23 July 2019, pp. 7–8.

<sup>68</sup> Pacific National, sub. 22: 4.

- whether an access holder wishes to voluntarily relinquish any of its access rights in accordance with its access agreement. It is proposed that no relinquishment fee would be required to be paid in these circumstances, regardless of what relinquishment arrangements are included in the relevant access agreement<sup>69</sup>
- options for expansions.

Within three months after the initial capacity assessment report has been published, Aurizon Network must submit a detailed report to the Chair of the Rail Industry Group, the Independent Expert and the QCA showing the outcome of Aurizon Network's analysis and consultation on the existing capacity assessment and the transitional arrangements which it considers would most effectively and efficiently address the existing capacity assessment (cl. 7A.5(a)(iii)).

If Aurizon Network and affected end users have not reached agreement as to which of the transitional arrangements should be implemented, there is a process for the Independent Expert to consider, and the QCA to determine, the matter (cl. 7A.5(d)-(g)). In particular, the Independent Expert and QCA will consider which of the identified transitional arrangements will most effectively and efficiently resolve the existing capacity deficit, including with regard to which will result in the lowest net present cost applying the discount rate to all access holders.

In the event that Aurizon Network and affected end users agree that an expansion is the most effective and efficient option to address the existing capacity deficit, or the QCA so determines, then Aurizon Network will be obliged to undertake and fund the expansion up to an amount of \$300 million (in aggregate across all expansions required under this process) at the Approved WACC. Any such expansion will be subject to review and approval by the Independent Expert for efficiency and prudence, and the value of an expansion will be included in the regulatory asset base (cl. 7A.5(i)).

Aurizon Network's UT5 DAAU also includes an amendment to clause 2.4(e) to make the existing provision that nothing in the undertaking requires Aurizon Network or another party to an access agreement executed before the Approval Date to vary that agreement or act in a way that is inconsistent with the relevant agreement, be subject to particular provisions (for example, clause 7A.5 of the UT5 DAAU).

### QCA analysis and preliminary position

We are minded to approve the arrangements in the Revised UT5 DAAU. This includes Aurizon Network's requested revisions:

- Providing greater specificity about the clauses to which clause 2.4(e) will not apply. Aurizon Network said this reflected that it may be required to implement transitional arrangements that are inconsistent with an access agreement (cl. 7A.5(f)-(g)) and that it can be required to waive its rights to collect a relinquishment fee (cl. 7A.5).<sup>70</sup> Aurizon Network said that its requested revisions to clause 2.4(e) do not mean that an access holder can be required to vary, or act in a way that is inconsistent with, an access agreement.<sup>71</sup>
- Clarifying that in determining under clause 7A.5(g)(iii) whether a transitional arrangement would put Aurizon Network in breach of an access agreement (and hence would prevent Aurizon Network from implementing that arrangement), that determination would be made

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<sup>69</sup> Schedule F also includes consequential amendments to the revenue-cap provisions (see cl. 4.3).

<sup>70</sup> Aurizon Network, Response to QCA RFI question 5, 1 August 2019, p. 3.

<sup>71</sup> Aurizon Network, Response to QCA RFI question 5, 1 August 2019, p. 4.

on the basis that any change in a system operating parameter had been reflected in the relevant access agreement as contemplated by clause 7A.12.<sup>72</sup>

- Setting out arrangements that apply in the event Aurizon Network and affected end users agree that an expansion is the most effective and efficient option to address the existing capacity deficit but have not agreed on the terms of the expansion proposal by the date it is required to be submitted to the independent expert. In these circumstances, Aurizon Network may, acting reasonably, determine the expansion proposal to be submitted to the independent expert for approval. Aurizon Network said that the terms of an expansion proposal it could determine would only relate to things required for the Independent Expert to assess when considering efficiency and prudence of the expansion, such as the cost, scope and standard of works; it would not include other terms of an expansion such as capacity allocations.<sup>73</sup>
- Providing further detail on what is to occur if the Independent Expert does not approve a proposed expansion as being prudent and efficient (see cl. 7A.5(i)(i)). In this case, Aurizon Network will be obliged to submit for approval an alternative proposal that will address the existing capacity deficit.<sup>74</sup>
- Enabling the QCA to extend the 15 day timeframe for its determination under clause 7A.5(e) to such longer period as may be required by the QCA.<sup>75</sup>

We are minded to approve the arrangements in respect of an existing capacity deficit in the Revised UT5 DAAU. We recognise these have been made as part of a package of amendments agreed between Aurizon Network and a diverse and overwhelming number of coal producers.

Pacific National expressed concern that Aurizon Network or the Rail Industry Group may collectively push transport supply chain costs arising from an existing capacity deficit through to above-rail operators, especially as it considered supply chain participants had an inability to press for consideration of their interests.<sup>76</sup>

In contrast, New Hope Group considered the capacity assessments of the Independent Expert creates a risk that there may be a requirement for additional capital expenditure on below rail infrastructure, which could increase access charges. It queried whether the arrangements in Aurizon Network's UT5 DAAU have the effect of potentially imposing unquantified additional costs onto the below rail component of the supply chains, which it considered may pose a disproportionate risk to new projects, which are more sensitive than existing established operations to additional fixed costs.<sup>77</sup>

We acknowledge the possible transitional arrangements outlined in Aurizon Network's UT5 DAAU include some transitional arrangements which may involve changes to the operating practices of train operators, and note that the DAAU is silent on the involvement of train operators in the agreement of those transitional arrangements. We consider this does not mean that the agreement of train operators for these transitional arrangements is not needed, but that the agreement of the train operator will be a matter for commercial negotiation

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<sup>72</sup> Aurizon Network, Response to QCA RFI question 5, 1 August 2019, p. 4.

<sup>73</sup> Aurizon Network, Response to QCA RFI question 2, 17 September 2019, p. 1.

<sup>74</sup> Aurizon Network, Response to QCA RFI question 4, 1 August 2019, pp. 2–3.

<sup>75</sup> Aurizon Network, Response to QCA RFI question 3, 1 August 2019, p. 2.

<sup>76</sup> Pacific National, sub. 22: 4.

<sup>77</sup> New Hope Group, sub. 23: 1–2.

between the relevant parties and the train operator. We understand that a train operator cannot be compelled to change their operating practices, without their consent. We may revisit our position on this matter, if this understanding is not correct.

In the event there is no agreement between affected parties, Aurizon Network's proposal requires the Independent Expert to make a recommendation, and the QCA to make a determination, about which transitional arrangement will most efficiently and effectively resolve the existing capacity deficit. We note Aurizon Network's statements that it is intended the Independent Expert will consider all matters it considers relevant and that its consideration will not be confined to Aurizon Network's report.<sup>78</sup> The Independent Expert will benefit from Aurizon Network's commitment to provide any information requested for it to undertake its functions (see section 5.2). Further, it is also intended that the QCA may consult with relevant parties before making its determination.<sup>79</sup>

We consider the reference to the effectiveness of a transitional arrangement directs the QCA to have regard to, among other things, the willingness of a party, such as a railway operator, to implement the relevant transitional arrangement.

Aurizon Network's proposed arrangements also provide that the QCA's determination must be consistent with the system operating parameters—other than is required to accommodate an operational change deemed prudent by the QCA for the purposes of rectifying the existing capacity deficit. We interpret this provision as being concerned with changes to system operating parameters that would have an impact on the capacity modelling that underpins the calculation of the existing capacity deficit (i.e. changes to the assumptions used in the calculation of the existing capacity deficit that reduce the quantum of the existing capacity deficit) and is not about the QCA making a determination that will result in changes to the operating practices of train operators or other supply chain participants. Aurizon Network confirmed the DAAU does not oblige any party other than Aurizon Network to implement a transitional arrangement determined by the QCA.<sup>80</sup>

New Hope Group also expressed concern as to how expansion processes that have been already triggered will interact with subsequent processes to address any latent capacity deficits, as it considered there is a risk that existing processes may be delayed or overtaken by these later processes, which would advance the interests of existing users ahead of access seekers.<sup>81</sup> It is not clear to us how this concern can be addressed in the terms of the undertaking. In the absence of further information, we consider this could be addressed through the undertaking's dispute resolution process.

### 2.2.3 System capacity assessment

In addition to the initial/annual capacity assessment, the Independent Expert will also be required to undertake an annual 'system capacity assessment' (cl. 7A.4.3). These arrangements are to replace an existing process in the UT5 Undertaking for the preparation of a system capacity assessment by Aurizon Network (cl. 7A.4.3 of the UT5 Undertaking).

While examining similar matters as the other capacity assessments, the purpose of this assessment is to provide Aurizon Network, access holders and customers with an assessment of

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<sup>78</sup> Aurizon Network, Response to QCA RFI question 27, 23 July 2019, p. 9.

<sup>79</sup> Aurizon Network, Response to QCA RFI question 27, 23 July 2019, p. 9.

<sup>80</sup> Aurizon Network, Response to QCA RFI question 7, 1 August 2019, p. 5.

<sup>81</sup> New Hope Group, sub. 23: 3.

a coal system's capacity for information purposes. Aurizon Network said the system capacity assessment differs from the annual capacity assessment in two significant respects:

- it is provided for information purposes only and it does not affect contracting for below rail capacity or any other matter
- it considers the capacity and operations of each element of the supply chain, including loading facilities, load out facilities, coal export terminals and interfaces between the different coal systems.<sup>82</sup>

A copy of the system capacity assessment will be given to Aurizon Network, and the Chair and members of the Rail Industry Group on a redacted basis (cl. 7A.4.3(b)).

### QCA analysis and preliminary position

We are minded to approve the arrangements in the Revised UT5 DAAU for the system capacity assessment.

We note that these arrangements do not have an express requirement for the system capacity assessment to be given to supply chain participants, including port operators. Gladstone Ports Corporation commented on this aspect and said that, as a port and terminal operator within the supply chain, it requires a clear right to obtain the system capacity assessment as it could contain information that has a material impact on port operations at the Port of Gladstone and to Gladstone Ports Corporation.<sup>83</sup>

We appreciate the information this assessment contains may be highly relevant and beneficial to supply chain participants (such as port and rail operators) and that the report should be provided to them. While not explicitly provided for in the UT5 DAAU, Aurizon Network has said that the system capacity assessment can be provided to the QCA on an unredacted basis and published on Aurizon's website on a redacted basis.<sup>84</sup> We consider Aurizon Network and the Rail Industry Group will be incentivised to do so given that it may lead to productivity improvements across the supply chain, and might lead to greater engagement and information provision to the Independent Expert by supply chain participants, ultimately improving the quality of the system capacity assessment report.

## 2.3 Rebate

Aurizon Network's UT5 DAAU includes a new rebate mechanism to apply from the report date (i.e. after the Independent Expert has completed the initial capacity assessment, and Aurizon Network provides its detailed report on proposed solutions to any identified existing capacity deficit) (cl. 7A.6). Aurizon Network said the rebate 'creates a material financial imperative for Aurizon Network to meet its contracted obligations to deliver train service entitlements.'<sup>85</sup>

The Independent Expert will determine whether a rebate is payable in a given year. The rebate is payable in circumstances where there has been any 'AN performance shortfall' resulting from an 'AN performance breach' in the relevant year in respect of an origin and destination combination in an access holder's access agreement (that is, an access holder has utilised less than its contracted train service entitlements due to Aurizon Network breaching an obligation

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<sup>82</sup> Aurizon Network, Response to QCA RFI question 24, 23 July 2019, p. 8.

<sup>83</sup> Gladstone Ports Corporation, sub. 21: 2.

<sup>84</sup> Aurizon Network, Response to QCA RFI question 24, 23 July 2019, p. 8.

<sup>85</sup> Aurizon Network, sub. 1: 11.



under its undertaking or access agreement, acting inconsistently with the approved maintenance strategy and budget other than as permitted, or failing to comply with a system operating parameter) (cl. 7A.6(b)). The rebate amount is calculated to reflect the AT2–AT5 components of the relevant access charges.

Since the submission of its proposal, Aurizon Network has requested revisions to the rebate mechanism to account for how a rebate will be determined in the first year of its operation and the period until transitional arrangements are implemented.<sup>86</sup>

Aurizon Network's proposal also includes amendments to provide that Aurizon Network will not rely on certain contractual provisions in an access agreement or access interface deed to avoid or reduce a rebate which would otherwise be payable (cl. 5.4). As an example of the operation of this clause, Aurizon Network said the five per cent threshold for cancelled train services under the standard access agreement (see cl. 25.4(b)(v) of the standard access agreement) does not have to be exceeded for the rebate to apply.<sup>87</sup>

To be eligible to receive a rebate, the access holder/end user must enter into a written undertaking with Aurizon Network to limit the ability of an access holder/end user to receive a rebate and seek other compensation for a breach associated with the 'AN performance breach' (cl. 7A.6(c)), subject only to other rights available to the access holder and end user, such as for a wilful breach by Aurizon Network of an access agreement or undertaking or rights under the QCA Act. Aurizon Network said it is intended that a written undertaking would be given on a case-by-case basis after it is first established that the rebate is payable. It also said that the reference to 'wilful breach' is a reference to the term as generally understood at common law, and not a reference to the wilful breach provisions that were included in the UT5 Undertaking, and are proposed to be removed through Aurizon Network's proposed amendments.<sup>88</sup>

Aurizon Network's proposal also includes a review process for the rebate mechanism. An end user may trigger a review of the rebate mechanism in January 2023 (cl. 7A.6(f)-(j)). This enables the QCA to publicly review the rebate mechanism against a prescribed set of rebate objectives and determine whether amendments should be made to the undertaking to ensure those rebate objectives are achieved.

If Aurizon Network does not comply with any amendments to the undertaking required by the QCA, or proposes an alternative that is agreed by a majority of end users, the rebate mechanism will cease to apply and a reduced WACC will apply (refer to section 1.5). These arrangements include a window within which the QCA can make its determination, although Aurizon Network said this was effectively a target date as the undertaking cannot oblige the QCA to make the decision within that timeframe. Aurizon Network confirmed that if the QCA does not meet the target date, the consequential actions under this process will continue to apply and be deemed to have effect from the reset date (i.e. there is a back-dating mechanism).<sup>89</sup>

### QCA analysis and preliminary position

The rebate mechanism applies to end users. Aurizon Network said that the rebate mechanism was not intended to, and would not apply to, non-coal access holders, given the rebate amount

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<sup>86</sup> Aurizon Network, Response to QCA RFI questions, 23 July 2019, *Rebate Drafting*, pp. 1–2.

<sup>87</sup> Aurizon Network, Response to QCA RFI question 32, 23 July 2019, p. 10.

<sup>88</sup> Aurizon Network, Response to QCA RFI question 36, 23 July 2019, p. 10.

<sup>89</sup> Aurizon Network, Response to QCA RFI question 38, 23 July 2019, p. 12.



is linked to reference tariffs which do not apply to non-coal access holders. It said a rebate was never applicable to any access holders prior to its UT5 DAAU and that consequently non-coal access holders are not worse off (as compared to their current contractual entitlements) by the reason of the rebate mechanism not applying to them.<sup>90</sup> We do not consider that the rebate mechanism necessarily needs to apply to non-coal access holders. However, this will be a matter that we consider when assessing whether non-coal access holders are materially worse off under the overall arrangements proposed under Aurizon Network's proposals, particularly in light of the amendments to maintenance obligations (this issue is discussed further in section 3.3).

We are minded to approve the rebate mechanism in the Revised UT5 DAAU, noting the rebate mechanism has been developed as part of a package of amendments negotiated by Aurizon Network and its coal producer customers. This includes the consequential amendments in Schedule F that account for the interaction with the revenue-cap provisions.<sup>91</sup>

We consider the proposed rebate mechanism is reasonable but note that its application and effectiveness will depend on the Independent Expert's assessment of whether particular train services were not delivered due to an Aurizon Network performance breach, as well as the Independent Expert receiving sufficient information so as to be able to make that determination.

Aurizon Network said that it expected the Independent Expert will be required to provide reasons to the relevant end user for its determination as to whether, and the extent to which, a rebate is payable.<sup>92</sup> Aurizon Network has also requested revisions to its DAAU by including a new clause 7A.6(o) that will enable an end user to raise a dispute under Part 11 of the undertaking if the Independent Expert determines that:

- Aurizon Network is liable to pay a rebate, and Aurizon Network does not dispute that determination within 20 business days, but Aurizon Network fails to pay the rebate within the required timeframe
- Aurizon Network failed to provide the information required for the Independent Expert to make a decision as to whether a rebate is payable or the amount of the rebate.<sup>93</sup>

We note this requested revision implies that Aurizon Network will have the ability to dispute a rebate determined by the Independent Expert.

If any issues about the effectiveness of the rebate mechanism emerge in future, we note this can be considered as part of the proposed review process for the rebate mechanism. On this point, we note Aurizon Network's statement that the QCA can make recommendations in relation to the matters captured by the rebate objectives, such as changes that would give greater transparency of information given to the Independent Expert to determine the rebate, although it cannot make changes to the circumstances in which the rebate would be payable and the amount of the rebate. However, it is expected we could recommend amendments to correct drafting errors that enable Aurizon Network to avoid the timely and effective provision of the rebate.<sup>94</sup>

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<sup>90</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, p. 11.

<sup>91</sup> Including, Cl. 4.3(e).

<sup>92</sup> Aurizon Network, Response to QCA RFI question 34, 23 July 2019, p. 10.

<sup>93</sup> Aurizon Network, Response to QCA RFI question 9, 1 August 2019, p. 5.

<sup>94</sup> Aurizon Network, Response to QCA RFI question 38, 23 July 2019, p. 12.

## 2.4 Supply chain coordination body

Aurizon Network has proposed the inclusion of a new process for the development, and consideration of, a proposal for the establishment of an independent supply chain coordination entity (cl. 7A.8.1). This includes arrangements for the establishment of a working group to develop the proposal, as well as outlining particular matters to which regard must be had when developing the proposal. Each supply chain participant will have the right to nominate a representative to the working group (cl. 7A.8.1(b)), and Aurizon Network cannot implement a supply chain proposal without the unanimous support of all supply chain participants in the relevant coal system (cl. 7A.8.1(g)).

### QCA analysis and preliminary position

We are minded to approve the amendments in the Revised UT5 DAAU. We consider the process for development of a supply chain coordination entity includes adequate consideration of the interests of supply chain participants and notes a proposal can only be implemented with unanimous support. Gladstone Ports Corporation said it 'strongly supports' its direct involvement in the supply chain coordination entity and working groups tasked to deliver the supply chain proposal.<sup>95</sup>

Any amendments to the undertaking needed to give effect to the implementation of the supply chain coordination body (if any) would need to be assessed by the QCA in accordance with the relevant provisions of the QCA Act.

## 2.5 Capability Train Plan Principles (Schedule G)

Aurizon Network's proposal includes amendments to the train plans that are provided for under Schedule G of the UT5 Undertaking. Specifically, Aurizon Network has proposed the establishment of a new 'capability train plan' (cl. 3A of Schedule G). The purpose of this train plan is to demonstrate that Aurizon Network has sufficient capacity to deliver existing train service entitlements in each coal system for each month of the capacity assessment period, having regard to certain possessions, existing capacity, the system operating parameters and the relevant characteristics of the coal system. The capability train plan is to be developed on an annual basis and will be given to the QCA and published by Aurizon Network, subject to Aurizon Network's confidentiality obligations. Aurizon Network's obligations to prepare this train plan will take effect after the date the Independent Expert's initial capacity assessment report is published.

The proposed amendments also include removing the strategic train plan and master train plan, once the Independent Expert's initial capacity assessment report is published (cls. 2.1(h) and 3.1(h) of Schedule G). As a consequence, Aurizon Network has proposed amendments to replace particular references to the master train plan to the intermediate train plan.<sup>96</sup>

### QCA analysis and preliminary position

Aurizon Network said it has proposed the removal of these plans as the combination of the reports provided by the Independent Expert, the intermediate train plan and capability train

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<sup>95</sup> GPC, sub. 21: 2.

<sup>96</sup> See, for example, cl. 5.1(f) and cl. 3 of Schedule A.

plan will provide access holders, customers and train operators with all of the information they rely upon to schedule train services.<sup>97</sup>

We are minded to approve these arrangements as outlined in the Revised UT5 DAAU. In the absence of any issues identified by stakeholders, we consider these amendments are appropriate to approve and continue to provide transparency in how Aurizon Network demonstrates it has sufficient capacity to deliver train services entitlements.

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<sup>97</sup> Aurizon Network, Response to QCA RFI questions 74, 75 and 76, 23 July 2019, p. 19.

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## 3 AMENDMENTS TO NEGOTIATION FRAMEWORK AND STANDARD AGREEMENTS (PARTS 4 AND 5)

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Aurizon Network's proposal includes a range of amendments in relation to the process for applying, negotiating and developing access agreements (Parts 4 and 5).

### 3.1 Part 4—Negotiation framework

Amendments have been proposed to Part 4 of the undertaking, which sets out the negotiation framework. These amendments are mainly to reflect the new capacity assessments proposed to be performed under Parts 7A and 8. These amendments include establishing a role for the Independent Expert (to be appointed under Part 7A) to certify whether there is sufficient available capacity to provide access rights sought in an access application. In particular, the Independent Expert must certify whether there is sufficient available capacity or that an expansion is required before Aurizon Network may provide the indicative access proposal, with the timeframe for the provision of the indicative access proposal being such period as may be required for the Independent Expert (cl. 4.6(e)).

Aurizon Network's UT5 DAAU also proposes the removal of clause 4.8(d)(iii)(B) of the UT5 Undertaking, which provided for the suspension of the negotiation process until a dispute about an expansion has been resolved. However, since submission of its UT5 DAAU, Aurizon Network has requested revisions to provide for the suspension of the negotiation period until a dispute in relation to clause 8.2.2(a) is resolved (i.e. a dispute about an expansion under Part 8).<sup>98</sup>

#### QCA analysis and preliminary position

We are minded to approve Aurizon Network's requested revisions to clause 4.8(d)(iii)(B), as it reflects that expansions may be subject to dispute resolution, in which case it is appropriate for the negotiation process to be suspended. This is incorporated in the Revised UT5 DAAU at Appendix 1.

We are minded to approve other proposed amendments to Part 4 within the Revised UT5 DAAU, noting they largely reflect the new capacity assessments and role of the Independent Expert as proposed by Aurizon Network and coal producers that developed Aurizon Network's UT5 DAAU proposal. While no specific timeframe has been given for the Independent Expert's certification before an indicative access proposal may be submitted, we consider the Independent Expert should perform this task in a reasonable timeframe and is not incentivised to unreasonably delay the negotiation process for access rights.

### 3.2 Part 5—Access agreements

Part 5 of the Aurizon Network's proposal sets out arrangements for the development of access agreements and train operations deeds.

Under the existing arrangements in Part 5 of the UT5 Undertaking, disputes about the terms of an access agreement (and train operations deed) are resolved by the parties completing and entering into an agreement on the terms of the standard access agreement (or standard train

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<sup>98</sup> Aurizon Network, Response to QCA RFI question 6, 1 August 2019, p. 4.

operations deed), or, in the case of access for non-coal carrying services, the relevant standard agreement amended to reflect the access is for non-coal carrying services (cls. 5.1(e) and 5.3(e)).

Aurizon Network's proposal includes amendments that will apply in circumstances where the parties have only partial disagreement on the terms of an access agreement or train operations deed. Any amendments that have been agreed by Aurizon Network and the access seeker/train operator are to be incorporated into the agreement entered into, with the remaining terms to be the same as those in the relevant standard agreement. Since the submission of its UT5 DAAU, Aurizon Network has requested to revise these amendments so that the drafting is consistent as between access agreements and train operations deeds.<sup>99</sup>

Further, Aurizon Network has proposed this mechanism for the resolution of a dispute will not apply for access conditions or where an expansion is agreed or determined to be required in accordance with clause 7A.5 (the proposed existing capacity deficit mechanism) or undertaken pursuant to Part 8 (Expansions). Aurizon Network said this amendment has been proposed because entering into an agreement on standard terms is not appropriate in these circumstances, given the agreements would be expected to include non-standard terms. However, since the submission of its UT5 DAAU, Aurizon Network has requested revising these amendments to clarify how disputes in these circumstances will be resolved. The requested revisions provide for disputes in these circumstances to be resolved in accordance with the dispute resolution mechanism in Part 11 of the UT5 Undertaking by the QCA or an expert completing or amending the relevant access agreement or train operations deed based on the standard agreement to the extent relevant.<sup>100</sup>

### QCA analysis and preliminary position

We are minded to approve the proposed amendments in respect of the dispute resolution mechanism for negotiations of the terms of an access agreement or train operations deed as outlined in the Revised UT5 DAAU as they clarify the operation of this dispute resolution mechanism. In particular, we consider it appropriate for disputes about the negotiation of access agreements or train operations deeds dependent on access conditions or expansions to be resolved in accordance with the dispute resolution process in Part 11. Further, we consider it appropriate to allow any amendments to the agreements to which the parties have agreed to be reflected in the agreement ultimately entered into, rather than defaulting to the relevant standard agreement entirely due to the parties not reaching complete agreement on all aspects of the terms of access.

## 3.3 Standard Access Agreements — Amendment of obligations regarding Aurizon Network's maintenance obligations

Aurizon Network's proposal includes amendments to its maintenance obligations in the UT5 Undertaking and the standard access agreement and train operations deed. These include:

- removal of obligations in the undertaking for Aurizon Network to use reasonable endeavours to minimise disruptions to train services when scheduling maintenance (cl. 7A.1.2 of the UT5 Undertaking)

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<sup>99</sup> Aurizon Network, Response to QCA RFI question 16, 23 July 2019, p. 5.

<sup>100</sup> Aurizon Network, Response to QCA RFI question 14, 23 July 2019, p. 4.

- removal of the 'wilful breach' provisions from the undertaking, standard access agreement and train operations deed, which provided an exclusion of certain allowable thresholds for non-provision of access in circumstances where Aurizon Network had wilfully breached its obligation to minimise disruptions to train services (see cls. 4.3(d)(iii) and 4.3(g)(ii) of Schedule F of the UT5 Undertaking; cl. 25.4(b) of the UT5 Undertaking Standard Access Agreement; cl. 28.4(c) of the UT5 Undertaking Standard Train Operations Deed)
- inclusion of a new clause 7A.11.1, which sets out a set of maintenance objectives for the manner in which Aurizon Network must carry out its maintenance work, which among other things, requires consistency with the approved maintenance strategy and budget, subject to permitted variations
- amendments to Aurizon Network's supply chain obligations, including providing that, subject to the terms of the undertaking and Aurizon Network not breaching its access agreement or safety standards, Aurizon Network must use reasonable endeavours to cooperate and coordinate with all elements of each supply chain with a view to: maximising the efficiency and performance of the relevant supply chain; and in planning and implementing operational constraints, to the extent practicable, minimising disruption to the operation of train services (cl. 7A.8.3).
- amendment of Aurizon Network's obligations under the standard train operations deed in relation to maintenance work (including using reasonable endeavours to minimise disruption to train services) so that these are subject to clause 7A.11 of Aurizon Network's UT5 DAAU undertaking and that these provisions of the undertaking will prevail to the extent of any inconsistency (cl. 21.2(a) of the UT5 DAAU standard train operations deed). Currently, the obligation to use reasonable endeavours to minimise disruption to train services will prevail over the undertaking to the extent of any inconsistency (cl. 21.2(j) of the UT5 Undertaking standard train operations deed).

### QCA analysis and preliminary position

We consider it relevant to consider the appropriateness of these proposed amendments in respect of their application to both coal and non-coal carrying services, particularly given Aurizon Network's proposal was developed with coal producers only.

#### Coal access holders

We recognise these amendments to maintenance obligations have been made as part of a package of arrangements agreed between Aurizon Network and a diverse and overwhelming number of coal producers. As such, the broad consensus on these arrangements, and the approach toward Aurizon Network's maintenance obligations these arrangements represent, is a matter we have taken into account when assessing the appropriateness of these amendments for coal-carrying train services.

We note the removal of the 'wilful breach' concept, which we approved as part of Aurizon Network's UT5 Undertaking. Aurizon Network said that the 'wilful breach' concept has been removed because it has agreed with industry the rebate mechanism, which operates without prejudice to a right of users to pursue remedies for a wilful breach by Aurizon Network of any access agreement or the undertaking (cl. 7A.6(c)(ii)(D)).<sup>101</sup> We consider the wilful breach concept in the existing UT5 Undertaking has a more specific purpose (i.e. an exclusion of certain

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<sup>101</sup> Aurizon Network, Response to QCA RFI question 85, 23 July 2019, p. 20.

allowable thresholds for non-provision of access) than the common law meaning of the term it appears Aurizon Network is referring to.<sup>102</sup> Nonetheless, we recognise that the rebate mechanism has been developed by Aurizon Network and coal producers, and that it can be seen as fulfilling a similar function as the previous wilful breach provisions, noting that the allowable thresholds for non-provision of access under the access agreement will not need to be exceeded before a rebate is payable.<sup>103</sup>

We also acknowledge the approach taken toward Aurizon Network's maintenance obligations, in particular replacing overarching obligations, such as using reasonable endeavours to minimise disruptions to train services (e.g. cl. 7A.3.1 of the UT5 Undertaking), with a more specific obligation to carry out maintenance works in a manner consistent with, among other things, the approved maintenance strategy and budget, noting it could potentially supersede Aurizon Network's maintenance obligations in the train operations deed to the extent of any inconsistency.

It is unclear to us what the scope and content of the maintenance strategy and budget will be and the extent to which it will delve into operational matters, such as the planning of operational constraints, which could impact on Aurizon Network's obligations under a train operations deed. Aurizon Network said the purpose of the maintenance strategy and budget is, in broad terms, to document the scope of maintenance work and the budget for carrying out that work and that it does not expressly outline how the committed capacity is to be delivered. It also said that in determining the scope of, and carrying out, maintenance work Aurizon Network must seek to ensure that the committed capacity is delivered (cl. 7A.11.1(a)(iii)(A)).<sup>104</sup> Aurizon Network also said the Rail Industry Group's review process for the maintenance strategy and budget will give the Rail Industry Group the opportunity to ensure that the maintenance strategy and budget will not diminish Aurizon Network's obligation to seek to ensure that the committed capacity is delivered.<sup>105</sup>

We acknowledge that end users of coal-carrying services will ultimately have the opportunity to approve the maintenance strategy and budget and that, at a broad level, they should collectively be incentivised to seek to ensure that committed capacity is delivered. Should there be a failure to obtain approval from end users, the QCA will determine the maintenance strategy and budget (the development and approval process for the maintenance strategy and budget is set out in section 1.2). In light of the consensus on these arrangements from end users of coal-carrying train services, we are minded to approve these arrangements.

We note that Aurizon Network has said the amendments to clause 21.2 of the standard train operations deed will apply to future train operations deeds and indicated these will not affect existing train operations deeds, unless these were amended in accordance with the mechanism under clause 7A.12 of Aurizon Network's UT5 DAAU.<sup>106</sup> As described above in section 3.2, it is the QCA's understanding this mechanism cannot require changes to a train operations deed to reflect these new arrangements, without the consent of the train operator.

In light of the consensus on these arrangements from end users of coal-carrying train services, above, and in the absence of any specific stakeholder concerns raised about these amendments

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<sup>102</sup> Aurizon Network, Response to QCA RFI question 36, 23 July 2019, p. 10.

<sup>103</sup> Cl. 5.4; Aurizon Network, Response to QCA RFI question 32, 23 July 2019, p. 10.

<sup>104</sup> Aurizon Network, Response to QCA RFI question 44, 23 July 2019, p. 13.

<sup>105</sup> Aurizon Network, Response to QCA RFI question 44, 23 July 2019, p. 14.

<sup>106</sup> Aurizon Network, Response to QCA RFI question 86, 23 July 2019, p. 20.

to maintenance obligations, we are minded to approve these amendments for coal-carrying train services as outlined in the Revised UT5 DAAU.

#### Non-coal access holders

In assessing the appropriateness of these amendments to non-coal access holders, we consider it relevant to consider whether non-coal access holders would be materially worse-off than under the existing UT5 Undertaking arrangements.

We note that, since the submission of its UT5 DAAU, Aurizon Network has requested revisions that are directed towards non-coal users. Specifically:

- providing that Aurizon Network will, in relation to the draft maintenance strategy and budget and draft renewals strategy and budget, engage in good faith discussions with non-coal access holders and customers, as well as provide updates on relevant new information and proposed amendments to the draft strategies and budgets to non-coal access holders and customers.<sup>107</sup> Under Aurizon Network's initial proposal, these obligations only extend to members of the Rail Industry Group (cl. 7A.11.3(c)).
- amending Aurizon Network's supply chain coordination obligation under clause 7A.8.3(a) to expressly reference that the elements of a supply chain includes non-coal users.<sup>108</sup>

Aurizon Network said that 'non-coal users will not be worse off as compared to their existing rights under UT5 and indeed will have enhanced rights under the DAAU as compared to their existing rights under UT5.'<sup>109</sup> Aurizon Network outlined a number of reasons for this position, including:

- By reason of its requested revisions to its UT5 DAAU (cl. 7A.11.3(c)), which provide for consultation with non-coal access holders and customers in the development of the draft maintenance strategy and budget, and draft renewals strategy and budget.<sup>110</sup>
- While non-coal access holders cannot receive a rebate, they can seek to enforce their contractual rights in relation to a failure by Aurizon Network to provide train service entitlements.<sup>111</sup>
- Non-coal users will have the benefit of an obligation for Aurizon Network to coordinate with other members of a supply chain (including non-coal users) to not only minimise disruptions when planning and implementing operational constraints, but also to seek to maximise the efficiency and performance of the relevant supply chain. Further, non-coal access holders will also be involved in the process for the development of an independent supply chain coordination body.<sup>112</sup>
- The annual capacity assessments expressly requires the Independent Expert to have regard to the extent of non-coal traffic on the rail infrastructure, and the extent to which non-coal traffic takes priority over coal traffic, including by reason of Aurizon Network's obligations to comply with passenger priority and preserved train path obligations (cl. 7A.2(a)(vi)).<sup>113</sup>

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<sup>107</sup> Aurizon Network, Response to QCA RFI question 44, 23 July 2019, p. 14.

<sup>108</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, p. 11.

<sup>109</sup> Aurizon Network, Response to QCA RFI questions, 23 July 2019, p. 21.

<sup>110</sup> Aurizon Network, Response to QCA RFI questions, 23 July 2019, pp. 12, 21.

<sup>111</sup> Aurizon Network, Response to QCA RFI questions, 23 July 2019, pp. 12, 21.

<sup>112</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, pp. 11, 21.

<sup>113</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, pp. 11–12, 21.



- Any existing capacity deficit identified by the Independent Expert may ultimately result in transitional arrangements, including potentially expansions, for the benefit of non-coal and coal traffic users.<sup>114</sup>
- Non-coal access holders will be able to require updated system operating parameters developed by the Independent Expert, and provisions of the undertaking, to be reflected in an access agreement (cl. 7A.12).<sup>115</sup>
- Non-coal access holders are not required to contribute to the costs of the Independent Expert.<sup>116</sup>

Having regard to Aurizon Network's comments, we note the following:

- While non-coal users will continue to be able to seek to enforce their contractual rights:
  - non-coal users will not get the benefit of the existing wilful breach provisions, nor the alternative mechanism, the rebate mechanism which only applies to coal traffics; and
  - Aurizon Network's maintenance obligations under the train operations deed operate subject to clause 7A.11 of the undertaking, which includes Aurizon Network's maintenance strategies and budget
- While non-coal users will have the right to be consulted on Aurizon Network's maintenance strategies and budget, they will have effectively no voting rights in these processes and whether their input is reflected in the approved maintenance strategies and budget will be subject to the end users of coal-carrying services.

We seek stakeholder views on the impacts of Aurizon Network's proposals (including the revisions requested by Aurizon Network) on non-coal traffics. The views of stakeholders on this matter will assist us in making our forthcoming decision on whether Aurizon Network's UT5 DAAU is appropriate to approve and any amendments necessary to secure our approval.

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<sup>114</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, pp. 12, 21.

<sup>115</sup> Aurizon Network, Response to QCA RFI question 37, 23 July 2019, p. 12.

<sup>116</sup> Aurizon Network, Response to QCA RFI question 22, 23 July 2019, p. 7.

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## 4 AMENDMENTS TO NETWORK DEVELOPMENT AND EXPANSIONS (PART 8)

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Aurizon Network's UT5 DAAU proposes various amendments to Part 8 of the existing UT5 Undertaking, which sets out arrangements for how expansions will be developed and funded. There are three key sets of proposed amendments in the DAAU:

- the inclusion of a committed expansion funding amount
- revised arrangements for the funding of expansions
- the inclusion of a new process for dealing with expansion capacity deficits.

### 4.1 Committed expansion funding amount

Aurizon Network has proposed a new obligation for it to commit to fund up to \$30 million each year of the proposed regulatory term for a proposed expansion that will increase the capacity of a coal system for the benefit of more than one access seeker, customer or access holder (the committed expansion funding amount). The committed expansion funding amount will be indexed each year and any unexpended portions will be carried over into the next year (cl. 8.2.1(ii)).

It is proposed that any amount of the committed expansion funding amount that is used by Aurizon Network will be deemed to form part of the regulatory asset base and will not require separate approval by the QCA, and will be subject to socialisation to apply to all 'expansion stakeholders'<sup>117</sup> (cl. 8.2.1(ii)(F) and (G)). Aurizon Network said this funding commitment was given on the basis of cost recovery through recognition of the value of the commitment in the regulatory asset base, which ensures the expenditure:

- is not subject to the risk of being excluded from the regulatory asset base
- is subject to inclusion in the system reference tariff and subject to the same pricing and risk as the value of the assets in the regulatory asset base.<sup>118</sup>

Aurizon Network also said the socialisation of this funding commitment is appropriate, given the annualised funding commitment is not material relative to the size of the regulatory asset base and that it must increase the capacity of a coal system for the benefit of more than one access seeker, access holder or customer.<sup>119</sup>

#### QCA analysis and preliminary position

We are minded to approve the arrangements in respect of the committed expansion funding amount as outlined in the Revised UT5 DAAU. The proposed socialisation arrangement does mean that access charges for system users that are not party to the expansion may be increased as a result of the committed expansion funding amount. While that may be the case, the relatively small amount of the committed expansion funding amount, when compared to the

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<sup>117</sup> Expansion stakeholders is defined under cl 6.4.1 and extends to all expanding users and all non-expanding users (access seekers and access holders) within a coal system.

<sup>118</sup> Aurizon Network, Response to QCA RFI question 17, 23 July 2019, p. 5.

<sup>119</sup> Aurizon Network, Response to QCA RFI question 53, 23 July 2019, p. 16.

overall regulatory asset base, decreases the likelihood of this causing a material increase in access charges for a non-expansion user.

Further, while the committed expansion funding amount will be deemed to be included in the regulatory asset base, the proposed expansion will still need to follow the other processes in Part 8 and Schedule E of the undertaking (cl. 8.2.1(b)(ii)(E)). This means the expansion will need to be the subject of concept and feasibility studies that are designed to assess the technical and economic feasibility of an expansion and should minimise the risk of expansions that are not prudent or efficient. Any balance of the funding for the expansion (i.e. any required funding beyond the committed expansion funding amount) will also still be subject to the approval processes for inclusion in the regulatory asset base.

## 4.2 Funding expansions

Aurizon Network's proposal retains the overall approach under the existing UT5 Undertaking regarding the funding of expansions, including the availability of user funding (cl. 8.7.1). That is, an access seeker will have the option for user funding if Aurizon Network is either unwilling to fund the expansion or only willing to fund the expansion subject to access conditions.

However, additional processes have been included for when an access seeker pursues user funding for an expansion. These require Aurizon Network to be provided with a reasonable opportunity to participate in the process the access seeker uses to fund the expansion (e.g. either participate in a competitive funding process carried on by the access seeker, or to propose its own funding terms to the access seeker if the access seeker proposes to fund the expansion itself). The access condition provisions in Part 6 of the Undertaking, which would otherwise require public consultation and QCA approval of proposed alternative terms and conditions for an expansion, do not apply to any proposals made by Aurizon Network in this process (cl. 6.13.3). However, for clarity, funding an expansion through access conditions will still be an option (cl. 8.7.1(a)(iv)).

Aurizon Network's proposal also includes other amendments related to the negotiation of user funding agreements.

Aurizon Network has proposed the removal of a clause providing that a failure to agree a user funding agreement can be the subject of a dispute under the undertaking (cl. 8.2.2(a)(iii) of the UT5 Undertaking). However, since the submission of its UT5 DAAU, Aurizon Network has requested revisions to reinsert this clause so that parties will continue to have the right to raise a dispute under Part 11 of the undertaking about the unsuccessful negotiation of a user funding agreement.<sup>120</sup>

Aurizon Network has also proposed removing a clause that provided for a person other than an access seeker, access holder or customer to be the preference unit holder for a user funding agreement (cl. 8.8.1(a)(iii) of the UT5 Undertaking). Aurizon Network said this has been proposed due to the clause not being relevant for inclusion in the DAAU, as preference unit holders were a concept relevant to the standard user funding agreement<sup>121</sup> and will not always be relevant to a user funding agreement. Aurizon Network said this removal does not prevent

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<sup>120</sup> Aurizon Network, Response to QCA RFI question 54, 23 July 2019, p. 16.

<sup>121</sup> The standard user funding agreement refers to a proposed standard form user funding agreement that was ultimately not included in Aurizon Network's 2017 Undertaking.

that mechanism from being used as a method of attracting third party funding in a competitive funding process pursuant to clause 8.7.1(e) of Aurizon Network's UT5 DAAU.<sup>122</sup>

Aurizon Network has also proposed a requirement that, in circumstances where an expansion is partly funded by Aurizon Network and user funding, the terms of the user funding agreement may need to include terms to ensure Aurizon Network is in no better or worse taxation or accounting position than if the entire expansion was funded by expansion funders (cl. 8.7.1(l)). Aurizon Network said these terms will need to be specific to each agreement because the way to give effect to this principle will vary on a case-by-case basis depending on the particular funding methodology.<sup>123</sup>

### QCA analysis and preliminary position

We are minded to approve the arrangements for funding expansions included in the Revised UT5 DAAU.

We note Aurizon Network has requested revisions to its proposal. We would be minded to approve Aurizon Network's request to reinsert clause 8.2.2(a)(iii) of the UT5 Undertaking. This would give parties the right to raise a dispute under the undertaking in relation to the negotiation of a user funding agreement. By providing recourse to dispute resolution, this will ensure that user funded expansions cannot be frustrated due to a failure to successfully negotiate the terms of a user funding agreement.

With regard to the amendments providing Aurizon Network with the ability to participate in an access seeker's user funding process, we acknowledge the access condition process provides a level of transparency that would not be captured under these proposed arrangements. Nonetheless, it will ultimately be a decision for the access seeker whether it accepts alternative funding terms proposed by Aurizon Network through this user funding process; an access seeker will not be obliged to accept Aurizon Network's proposal (cl. 8.7.1(g)). The proposed arrangements also include measures to ensure Aurizon Network's participation in the process will not unduly delay an access seeker's user funding process, including a timeframe for Aurizon Network to seek to participate in the process (cl. 8.7.1(f)).

We would be minded to approve Aurizon Network's proposed amendments in relation to preference unit holders and terms of a user funding agreement ensuring Aurizon Network is in no worse taxation or financial position, in light of Aurizon Network's request to revise its UT5 DAAU to provide a right to raise a dispute if the terms of a user funding agreement cannot be negotiated.

## 4.3 Expansion capacity deficits

Aurizon Network's UT5 DAAU includes a new process for the Independent Expert to assess whether there is an expansion capacity deficit, following the commissioning of an expansion (cl. 8.9.4). That is, the Independent Expert has assessed that the deliverable network capacity created by the expansion is less than was required by the expansion or the relevant conditional access rights.

The Independent Expert will commence this role following the publication of the initial capacity assessment report (discussed in section 2.2.1); prior to that occurring, Aurizon Network will be

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<sup>122</sup> Aurizon Network, Response to QCA RFI question 56, 23 July 2019, p. 16.

<sup>123</sup> Aurizon Network, Response to QCA RFI question 55, 23 July 2019, p. 16.

responsible for assessing the relevant capacity change following an expansion and the existing arrangements for dealing with a capacity shortfall will apply (see cls. 8.9.1–8.9.3).

If the Independent Expert's assessment reveals an expansion capacity deficit, Aurizon Network will prepare a report showing the outcome of Aurizon Network's analysis and consultation on the deficit, and solutions which it considers would most effectively address the deficit (cl. 8.9.4(f)). The QCA must then make a determination as to whether Aurizon Network is required to undertake a further expansion to rectify the deficit. The QCA cannot make that determination if the Independent Expert considers Aurizon Network has complied in all material respects with its relevant obligations, or Aurizon Network and the relevant access holders agree a further expansion is not required (cl. 8.9.4(g)). As an example, Aurizon Network said it could be required to undertake a further expansion if Aurizon Network failed to deliver a specific scope required for the expansion.<sup>124</sup>

If the QCA determines that Aurizon Network should undertake a further expansion to rectify the deficit, the Independent Expert must review and approve the efficiency and prudence of the proposed further expansion, including proposing an alternative option, if necessary. The processes and requirements of Part 8 of the undertaking will apply to the further expansion and its inclusion into the RAB will be determined under Schedule E to the extent those costs are reasonable and prudent, with Aurizon Network responsible for any costs that are not reasonable and prudent (cl. 8.9.4(h)). If the Independent Expert proposes an alternative option for the expansion, Aurizon Network said the scope of the expansion would be identified by the Independent Expert when it proposes the alternative option but the QCA would need to approve the prudence of the cost.<sup>125</sup>

### QCA analysis and preliminary position

We are minded to approve the arrangements for resolving expansion capacity deficits as outlined in the Revised UT5 DAAU. The proposed process provides a level of transparency, given the Independent Expert's assessment of whether there is an expansion capacity deficit will be made publicly available, and the requirement for Aurizon Network to consult with conditional access holders when developing its proposed response to a deficit.

We note Aurizon Network's proposal sets out a 15 day timeframe for the QCA's determination about whether Aurizon Network is required to undertake a further expansion. However, since the submission of its UT5 DAAU, Aurizon Network requested revisions to provide that the 15 day timeframe may be extended to such longer period as may be required by the QCA.<sup>126</sup>

We are minded to approve Aurizon Network's requested revisions. This will be an important determination that is likely to require complex considerations and potentially involve reconciling competing views from Aurizon Network and affected parties about whether a further expansion should be undertaken. As such, we may need to consult further or obtain additional information in order to make the determination. Aurizon Network has confirmed that its UT5 DAAU arrangements are not intended to restrict the QCA in respect of the method by which it makes the determination and that the QCA can consult with the Independent Expert and affected parties.<sup>127</sup> On that basis, Aurizon Network's proposed revision acknowledges that

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<sup>124</sup> Aurizon Network, Response to QCA RFI question 58, 23 July 2019, p. 17.

<sup>125</sup> Aurizon Network, Response to QCA RFI question 59, 23 July 2019, p. 17.

<sup>126</sup> Aurizon Network, Response to QCA RFI question 3, 1 August 2019, p. 2.

<sup>127</sup> Aurizon Network, Response to QCA RFI question 58, 23 July 2019, p. 17.

the QCA may need further time to make determination, including to carry out consultation as appropriate.

We also note Aurizon Network's confirmation that the Independent Expert's reports under Part 8 of the undertaking can be disputed in accordance with the undertaking's dispute resolution process, given the operation of clause 8.2.2.<sup>128</sup>

#### 4.4 Other matters

Aurizon Network's UT5 DAAU also includes other amendments related to expansion processes, including those outlined in the table below.

**Table 2**

<i>Proposed amendment</i>	<i>QCA analysis and preliminary position</i>
Prior to Aurizon Network agreeing to fund, construct or permit an expansion, it must consider whether the need for an expansion could be avoided by the resumption of access rights in accordance with an access agreement and, if so, follow the relevant process for the resumption, acting reasonably and in good faith (cl. 8.2.1(r)).	We are minded to approve this amendment, noting it is reasonable for Aurizon Network to consider whether access rights can be resumed to avoid the need for an expansion. Any such resumption should only be able to occur as permitted in accordance with the relevant obligations and processes in an access agreement.
Removed scope for another party to be responsible for developing the design and considering the scope of work to deliver the capacity required by an expansion, in circumstances where Aurizon Network did not agree to seek reimbursement of only its efficient costs to the extent these are not recovered by Aurizon Network under the undertaking. Further, the Independent Expert will confirm the design will deliver the capacity required by the expansion (cl. 8.2.1(l)), as well as performing capacity analysis for the purposes of feasibility studies (a function previously performed by Aurizon Network) (cl. 8.3.3(b)(ii)).	<p>We note that Aurizon Network will be responsible for developing the design and considering the scope of work for an expansion to deliver the required capacity. The associated costs incurred by Aurizon Network will be assessed by the QCA to determine efficiency and prudence under clause 2 of Schedule E.<sup>129</sup> Moreover, the Independent Expert will be responsible for confirming the design will deliver the capacity required to provide access rights.</p> <p>We are minded to approve these amendments, noting that these represent consensus positions agreed between a diverse and overwhelming number of coal producers (both access holders and access seekers). The QCA's assessment of these costs will incentivise Aurizon Network to incur prudent and efficient expenditure.</p> <p>The involvement of the Independent Expert in confirming the design will deliver capacity and in a feasibility study is also consistent with the proposed capacity assessment role for the Independent Expert throughout Aurizon Network's UT5 DAAU arrangements. We are minded to approve this amendment.</p>
Aurizon Network's obligations to not enter into an access agreement unless there is available capacity or is conditional on an expansion being undertaken, now does not apply to renewing access seekers (cl. 8.9.1).	Aurizon Network said a renewal by a renewing access seeker is carved out of clause 8.9.1 as its access rights are not dependent on an expansion given that is renewing existing access rights and not seeking additional access. <sup>130</sup>

<sup>128</sup> Aurizon Network, Response to QCA RFI question 57, 23 July 2019, p. 17; Aurizon Network, Response to QCA RFI question 9, 1 August 2019, p. 6.

<sup>129</sup> Aurizon Network, Response to QCA RFI question 6, 9 August 2019, p. 6.

<sup>130</sup> Aurizon Network, Response to QCA RFI question 8, 1 August 2019, p. 5.

<b><i>Proposed amendment</i></b>	<b><i>QCA analysis and preliminary position</i></b>
	In light of the information provided by Aurizon Network, we are minded to approve this amendment.
<p>Pacific National said that Aurizon Network's UT5 DAAU should be amended so that all supply chain participants be provided with the ability to have their interests taken into account by Aurizon Network when conducting feasibility studies on the scope and standard of new capacity expansions.<sup>131</sup></p>	<p>Our task is to assess whether it is appropriate to approve Aurizon Network's UT5 DAAU. We do not consider it within the scope of our task to consider whether to require amendments to Aurizon Network's UT5 Undertaking that are unrelated to the UT5 DAAU. In the absence of any specific issues identified by Pacific National, we consider that Aurizon Network's UT5 DAAU does not propose any amendments to the participation of supply chain participants in the process for conducting feasibility studies, relative to the existing UT5 Undertaking. As such, we do not consider it appropriate to consider whether amendments should be made to the UT5 Undertaking on this matter.</p> <p>To the extent that Pacific National is referring to expansions to address existing capacity deficits under clause 7A.5, it is proposed that provisions in Part 8 of the undertaking related to concept, pre-feasibility and feasibility studies would not apply to these expansions (cl. 8.3.1A). However, we note the Independent Expert, and Aurizon Network's report in response, will include consideration of options for expansions, which would be expected to consider similar matters. Further, Aurizon Network is obliged to consult with parties, including train operators, when preparing this report. We may also decide to consult with affected parties when making a determination as to whether a further expansion is required.</p>
<p>New obligations require Aurizon Network to submit to the QCA capital expenditure for pre-approval in relation to expansions that are likely to involve an amount of:</p> <ul style="list-style-type: none"> <li>• \$10 million in respect of a single expansion project; or</li> <li>• \$20 million in total where the proposed expansion project includes more than one expansion project within a single coal system, within a year (Schedule E, cl. 2.3(f)).</li> </ul> <p>Prior to seeking pre-approval, Aurizon Network must notify relevant parties of its intention to seek pre-approval and obtain a report from the Independent Expert that confirms an expansion is required and that there will be sufficient available capacity following the expansion to deliver required access rights (Schedule E, cl. 2.3(g),(h)).</p> <p>Aurizon Network must also obtain this report from the Independent Expert when proceeding with a voting proposal under clause 4 of Schedule E, in relation to the expansion amounts outlined above</p>	<p>We are minded to approve new obligations requiring Aurizon Network to seek pre-approval of specific expansion projects. These obligations will provide transparency on decisions related to these expansions. Aurizon Network's submission will be assessed by the QCA, consistent with the approach currently applied in the existing UT5 Undertaking (Schedule E, cl. 2).</p> <p>The involvement of the Independent Expert in confirming the expansion will deliver capacity is also consistent with the proposed capacity assessment role for the Independent Expert throughout Aurizon Network's UT5 DAAU arrangements.</p>

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<sup>131</sup> Pacific National, sub. 22: 3.

<b><i>Proposed amendment</i></b>	<b><i>QCA analysis and preliminary position</i></b>
(Schedule E, cl. 2.3(h)).	



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## 5 AMENDMENTS TO RINGFENCING, REPORTING AND GOVERNANCE RELATED MATTERS

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Aurizon Network's UT5 DAAU includes a number of proposed amendments in relation to ringfencing and reporting obligations (Parts 3 and 10 respectively). The UT5 DAAU proposal also includes new obligations on governance related matters. These relate to voting rights and the Rail Industry Group, along with an end user DAAU mechanism.

### 5.1 Part 3—Ringfencing proposal

Aurizon Network's proposal includes a number of amendments to the Part 3 ringfencing arrangements. A number of these proposed amendments represent a strengthening of the provisions. Specifically:

- New obligations regarding independent management and governance (cl. 3.9).
- A new requirement for Aurizon Network to engage an independent observer (nominated by the Rail Industry Group) to attend its board meetings and report on compliance with the ringfencing obligations, and good corporate governance practices (cl. 3.9(e)).
- New drafting which renders Aurizon Network liable for unauthorised disclosure or use of Confidential Information by other persons within the Aurizon Group, where that information has been provided by Aurizon Network (cl. 3.13).
- Engagement with end users regarding the approval of transfers of senior and key Aurizon Network personnel to a Related Operator, and vice versa (cl. 3.6(b)).
- Execution of undertakings by all directors and specified senior and key personnel of Aurizon Network to comply with all confidentiality obligations set out in Part 3 (cl. 3.16).
- Stronger requirements regarding obtaining exit certificates from departing employees who have had access to Confidential Information (3.17).
- Stronger requirements regarding maintaining information security (3.18(a)).

Other proposed amendments include, but are not limited to:

- Removing descriptive content regarding organisation structure and clarifying the general application of the Part 3 provisions (cl. 3.1).
- Revisions to the proposed application of Part 3 when related party shareholdings change (cl. 3.1).
- Removal of the requirement to maintain a High Risk Personnel Register (cl. 3.16).
- Removal of the obligation to employ a regulatory affairs advisor (cl. 3.6(f)(i)).
- Less prescription regarding training requirements for personnel who have access to Confidential Information (cl. 3.15).
- Less prescription around 'self-insurance' information to be reported within Aurizon Network's financial statements (cl. 3.8(d)).
- Removal of provisions prohibiting waiver or exclusion by voluntary agreement (cl. 3.9).

Along with these amendments, Aurizon Network's proposed drafting consolidates and renames existing provisions across several areas, while largely retaining the intent and effect of the existing UT5 Undertaking provisions.

### QCA analysis and preliminary position

Aurizon Network's DAAU includes several proposed amendments that represent significant extensions of the UT5 ringfencing framework. These include a requirement for end users to approve staff transfers and secondments between Aurizon Network and its related parties, and the requirement for an independent observer to attend Aurizon Network Board meetings. Aurizon Network has also proposed new drafting which renders it liable for subsequent unauthorised disclosure or use of Confidential Information by other persons within the Aurizon Group, where that information has been provided by Aurizon Network (cl. 3.13).

In contrast, some proposed amendments could potentially be viewed as reducing transparency, or otherwise diminishing the strength of the ringfencing framework. Examples of these changes include the removal of the high risk personnel register and less prescriptive confidential information training requirements. We have sought clarification from Aurizon Network regarding the intent and reasoning for these proposed amendments.

After considering these amendments and the reasoning offered by Aurizon Network, we are minded to approve these amendments, on the basis that they represent changes that either:

- simplify, clarify or reduce unnecessary prescription of the original UT5 provisions
- remove provisions that have been superseded with new provisions intended to serve a similar purpose, or
- reflect other proposed changes which render some provisions no longer necessary or relevant, or where existing provisions are in conflict with other proposed amendments.

In general terms, these proposed amendments appear to streamline and simplify the ringfencing framework rather than diminish its strength or effectiveness. Where provisions have been redrafted and/or consolidated, the effect and intent appears to be consistent with the existing UT5 Undertaking provisions. A relevant example is the removal of the requirement to maintain a High Risk Personnel register. Under the DAAU, all senior Aurizon Network staff and key commercial personnel are effectively treated as 'high-risk' by default. In addition to receiving mandatory confidential information training, these staff must execute confidentiality undertakings (cl. 3.16). This proposed approach to recognising and mitigating risks regarding these personnel appears to be clearer and no less effective than the existing UT5 Undertaking provisions, while removing prescription that may be unnecessary.

Similarly, the prescriptive confidential information training requirements (cl. 3.15) are of less relevance under the DAAU given that Aurizon Network would have a stronger incentive to ensure staff compliance with confidentiality obligations under the proposed liability provision (cl. 3.16).

We note that Aurizon Network has requested revisions to its proposal that removes the requirement for the independent observer to provide its report to the QCA. Aurizon Network noted that there are no expectations on the QCA in relation to this report and that the report

will be published on Aurizon Network's website for all interested stakeholders to review.<sup>132</sup> On this basis, we are minded to approve these arrangements as reflected in the Revised UT5 DAAU.

Pacific National submitted that the ringfencing arrangements must appropriately protect the legitimate business interests of supply chain participants in light of the proposed amendments.<sup>133</sup> Pacific National expressed concern about proposed changes that may enable Aurizon Network to share the confidential information of certain participants, without necessarily obtaining the written consent of those affected parties.<sup>134</sup> Pacific National cited changes to clauses 3.6(b), 3.11(e)(ii) and 3.14(a) as areas of concern in this regard.

We have considered the concerns raised by Pacific National and the proposed amendments it identified at clauses 3.6(b), 3.11(e)(ii) and 3.14(a).

Firstly, with regard to voting rights to approve staff transfers and secondments under proposed clause 3.6(b), we note that only end users would be eligible to vote on these staff movements. However, above rail operators such as Pacific National (who are not end users), would not appear to be any worse-off when compared with the existing arrangements which do not provide for any user approval mechanism, and are limited to reporting of the secondment/transfer to the QCA in advance of it taking place (cl. 3.6(e)).

Secondly, we note that disclosure of Confidential Information under proposed clause 3.11(e)(ii) of the DAAU is not a new provision. Clause 3.13(c)(ii) of the existing UT5 Undertaking permits similar disclosure with the same intent and conditions.<sup>135</sup>

Lastly, clause 3.14 of the DAAU introduces a requirement for the Rail Industry Group to be consulted in determining amendments that may be required to the 'structure and level of detail of information' included in the Confidential Information Register (3.14(a)). We note that the proposed amendments to clause 3.14(a) would provide new scope for user (Rail Industry Group members) involvement in the development of the Confidential Information Register. Currently, only the QCA and Aurizon Network have a role in this process. This proposed amendment appears to offer greater, rather than less, user involvement in this process. Further, clause 3.14(a) does not appear to allow Aurizon Network to share the content of the Confidential Information Register, or the underlying Confidential Information that it describes, with Rail Industry Group members. In this regard, the amendments to clause 3.14 do not appear to be contrary to the interests of users.

We have considered Pacific National's concerns and are of the view that it is unlikely to be worse off under the proposed provisions, when compared with the existing UT5 Undertaking arrangements. We also note that the UT5 DAAU requires that the recipients of Confidential Information undertake to maintain the confidentiality of that information. We consider that the interests of Pacific National and other parties are adequately served by these measures, in a manner that is no less favourable or robust than that offered by the existing UT5 Undertaking arrangements.

The UT5 DAAU also includes amendments to Part 3 which would have the effect of revoking the application of many elements of the Part 3 ringfencing arrangements, in the event that Aurizon

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<sup>132</sup> Aurizon Network, Response to QCA RFI question 1, 27 August 2019, p. 1.

<sup>133</sup> Pacific National, sub. 22: 3.

<sup>134</sup> Pacific National, sub. 22: 3.

<sup>135</sup> Noting that disclosure under the proposed DAAU drafting refers to the recipient as a 'Coal Export Terminal Operator' rather than an 'infrastructure provider'.

Holdings or any related party cease to directly or indirectly own any shares in Aurizon Network. In such a scenario, Aurizon Network's proposed amendments would mean that the majority of Part 3 provisions would no longer apply, with the exception of some residual provisions relating to the handling and protection of confidential information. We sought further information from Aurizon Network regarding these proposed amendments. In response, Aurizon Network submitted that many elements of Part 3 would no longer be relevant if Aurizon Holdings or any of its related parties ceased to own shares in Aurizon Network. It also pointed to other sections of the QCA Act which provide protections in such a scenario.<sup>136</sup>

We consider that the proposed amendments to clause 3.1 would likely be appropriate in the event that Aurizon Network was no longer a part of the integrated Aurizon Holdings entity. However, the operation of the proposed clause 3.1 may not necessarily deliver a robust ringfencing framework under alternative ownership/shareholding scenarios that feature vertical integration. For example, it does not contemplate a scenario where a new shareholder or owner of Aurizon Network (that is not Aurizon Holdings or a related entity), operates or holds an interest in, an upstream or downstream entity. Notwithstanding this, we are cognisant that the access undertaking itself cannot reasonably be expected to include provisions that are appropriate and relevant under hypothetical alternative shareholding and structural scenarios.

We understand that, if a structural or shareholding change occurred that rendered the ringfencing provisions (or any other provision of the access undertaking) no longer appropriate, the QCA could require amendments to the undertaking under section 139 of the QCA Act to ensure that the undertaking in place complied with the requirements of section 137 of the QCA Act, particularly section 137(1A). On this basis, we are currently minded to consider the proposed amendments to clause 3.1 appropriate to approve. We are interested in stakeholder views on these matters and may revise its position based on the information received.

We also note that Aurizon Network proposes to remove clause 3.6(f)(ii) which precludes Aurizon Network from outsourcing 'regulatory functions or positions' to any other Aurizon Party. Clause 3.6(f)(ii) characterises these functions as tasks related to the development, application and interpretation of the undertaking in relation to Aurizon Network. We sought further information from Aurizon Network on the rationale for removing this clause. In response, Aurizon Network said that it considers these regulatory functions as matters related to the provision of Below Rail Services, as set out in clause 3.4(c) of the UT5 DAAU.<sup>137</sup> Aurizon Network noted that, under clause 3.7 of the UT5 DAAU, these Below Rail Services cannot be transferred, delegated or contracted out to a Related Operator of Aurizon Network other than as permitted by clause 3.7.<sup>138</sup>

In our view, it is unclear that the regulatory functions contemplated by clause 3.6(f)(ii) are definitively captured by the list of Below Rail Services identified at clause 3.4(c). However, we note that the definition of Below Rail Services at Part 12 of the UT5 DAAU (which is consistent with the existing UT5 Undertaking) may be sufficiently broad to encompass functions associated with developing, applying and interpreting an access undertaking. In this regard, the proposed removal of clause would not appear to have any material implications as the outsourcing of these regulatory functions would continue to be restricted by clause 3.7. We are currently minded to consider the proposed removal of clause 3.6(f)(ii) appropriate to approve. We are

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<sup>136</sup> Aurizon Network, Response to QCA RFI question 1, 9 August 2019.

<sup>137</sup> Aurizon Network, Response to QCA RFI question 2, 9 August 2019.

<sup>138</sup> Aurizon Network, Response to QCA RFI question 2, 9 August 2019.

seeking stakeholder views on this matter and may revise our position based on further information provided by stakeholders.

We have considered the remaining proposed amendments to Part 3 and has formed a preliminary view that the package of amendments adequately serves the interests of supply chain participants. In forming this preliminary view we note that the proposed amendments do not appear to be to the detriment of any participants, when compared with the approved UT5 Undertaking arrangements. We also do not consider the DAAU introduces obligations that are any less effective regarding the protection and disclosure of confidential information of end users and Access Holders, when compared with the existing UT5 arrangements.

Relevantly, as noted above, a number of the proposed amendments represent quite significant extensions of the ringfencing framework. These would impose significant new obligations on Aurizon Network, and increase transparency and accountability around Aurizon Network's decision making and governance processes.

For these reasons, and when considered overall as a package of amendments, we are minded to consider the proposed amendments to Part 3 appropriate to approve as outlined in the Revised UT5 DAAU. We welcome stakeholder views on our preliminary views.

## 5.2 Part 10—Reporting, compliance and audits proposal

Aurizon Network's UT5 DAAU proposal includes a number of amendments, in particular:

- New network performance reporting obligations. Monthly network performance reports provided by the Independent Expert are to replace existing network performance and maintenance reports (cl. 10.8).
- Additional audit obligations in relation to requiring an audit of Aurizon Network's compliance with its maintenance objectives and changes to audit cost recovery obligations (cl. 10.6).

Other obligations in Part 10 of Aurizon Network's proposal remain unchanged from the existing UT5 Undertaking.<sup>139</sup>

### Network performance reporting

Aurizon Network's proposal requires the provision of monthly network performance reports to Aurizon Network, access holders and their customers, train operators and the QCA (cl. 10.8.3). The monthly reports are to be prepared by the Independent Expert appointed in clause 7A.3 of the UT5 DAAU (see section 2.1 for information on the Independent Expert's appointment) and will provide:

- a record of train services and ad hoc train services that were requested, scheduled, delayed, cancelled or requested but not scheduled, along with a record of the extent to which access holders received their nominated monthly train services
- a root cause analysis of the underlying reasons for any train service or ad hoc train service being delayed, cancelled or not scheduled and a root cause analysis of the underlying reasons for an access holder's nominated monthly train services not being provided, along with the party responsible

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<sup>139</sup> Subject to minor formatting changes and rectification of cross reference errors.

- reasons for, and timing of, maintenance work, asset replacement and renewal work and possessions
- information on Aurizon Network's compliance with its maintenance objectives (cl. 7A.11.1) and obligations around the engagement of the Independent Expert (specifically Aurizon Network's obligation to provide source data for the Independent Expert to review (cl. 7A.3.1(a)(ii)))<sup>140</sup>
- detail on the availability of the network for train services, having regard to the whole coal system
- the average transit times and delays, measured in minutes per 100 train kilometres
- information on network service quality, including speed restrictions and track quality (measured by a quality index)
- distances travelled and tonnage hauled on coal-carrying train services (measured in gtk, nt, ntk and egtk); below-rail transit times; and the number of train paths used, contracted, available and available but not used
- instances of contested train paths and the outcomes of these matters
- other reports reasonably required by a majority of end users.<sup>141</sup>

Aurizon Network's proposal also requires the Independent Expert to prepare and provide additional monthly reports to each access holder and their customers that, in respect of the relevant access holder, will provide (cl. 10.8.4):

- a record of train services and ad hoc train services that were requested, scheduled, delayed, cancelled or requested but not scheduled, along with a record of the extent to which the access holder received its nominated monthly train services
- a root cause analysis of the underlying reasons for any train service or ad hoc train service being delayed, cancelled or not scheduled and a root cause analysis of the underlying reasons for the access holder's nominated monthly train services not being provided, along with the party responsible.

To assist in the provision of the monthly reports, Aurizon Network's proposal includes obligations outlining the information Aurizon Network must provide to the Independent Expert in relation to network performance (cl. 10.8.2). In addition, obligations are included that allow Aurizon Network to assist the Independent Expert in preparing and providing the reports for a 12 month transitional period (cl. 10.8.5).<sup>142</sup> Aurizon Network also proposes a broader obligation to provide the Independent Expert with information reasonably required to undertake its tasks as outlined in the undertaking (cl. 10.8.2(a)(xx)).

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<sup>140</sup> Aurizon Network, Response to QCA RFI question 66, 23 July 2019, p. 18.

<sup>141</sup> See section 5.3 for detail on the end user voting thresholds.

<sup>142</sup> Aurizon Network consider that the Independent Expert, as a newly created entity, will not have the technical capability from the start of its engagement to prepare the reports required under Part 10. Hence a transitional period has been proposed. Aurizon Network, Response to QCA RFI question 68, 23 July 2019, p.18.

### Removal of existing network performance reporting requirements in the UT5 Undertaking

Aurizon Network's proposal removes the existing UT5 Undertaking requirement for Aurizon Network to provide quarterly network performance reports (cl. 10.3.4 of the UT5 Undertaking). The quarterly reports present information on a range of performance measures, including network availability, service quality, reliability and safety.

Aurizon Network's UT5 DAAU proposal also removes existing UT5 Undertaking requirements to report on maintenance activities, including:

- Annual maintenance plans — Aurizon Network will no longer be required to provide a report and presentation to access holders and their customers on details of the planned scope of maintenance and renewal activities for the forthcoming year and the contents of maintenance cost reports for the previous year (cl. 10.3.1 of the UT5 Undertaking).
- Quarterly and annual maintenance reports — Aurizon Network will no longer be required to report its actual maintenance costs and scope achieved on an annual and quarterly basis, along with detail on asset renewals incurred in place of planned maintenance work, below rail transit times, overall track condition index results, safety incidents reported to the safety regulator and the number of derailments where recovery costs exceed \$100,000 (cl. 10.3.2 and cl. 10.3.3 of the UT5 Undertaking).
- Conditional maintenance performance report — Aurizon Network will no longer be required to report on train services disrupted as a result of Aurizon Network imposing operational constraints (cl. 10.3.5 of the UT5 Undertaking).

### Amendments to audit requirements

Amendments have been proposed to Aurizon Network's audit obligations. These mainly relate to audits of Aurizon Network's compliance with maintenance objectives and changes to cost recovery. However, amendments have also been made to clarify timing for the appointment of an auditor and the requirements an auditor must satisfy. Audits conducted on Aurizon Network's compliance with reporting obligations are proposed to identify whether information produced by Aurizon Network is inaccurate or misleading.

#### Audit of Aurizon Network's compliance with its maintenance objectives

Aurizon Network's proposal includes a framework for conducting audits in relation to Aurizon Network's compliance with the proposed maintenance objectives addressed throughout clause 7A.11.1. In addition to the QCA, end users (specifically an audit majority of end users)<sup>143</sup> are able to request Aurizon Network engage an auditor to undertake an audit on its compliance with clause 7A.11.1 — the maintenance objectives. The proposed framework involves end users throughout the audit process, including:

- allowing end users to jointly appoint a suitably qualified auditor with Aurizon Network
- requiring the auditor to have a duty of care to the relevant end users and Aurizon Network
- specifying that the audit plan include a process for consultation with the QCA, relevant end users and Aurizon Network to ensure the audit addresses the matters and standards required by the QCA or end users

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<sup>143</sup> See section 5.3 for detail on the end user voting thresholds.

- requiring the auditor to provide the audit results, with any confidential or commercially sensitive information redacted, to all end users
- requiring Aurizon Network to advise end users once it receives the audit report.

The proposed framework requires Aurizon Network to explain the extent to which it has implemented any recommendations made by the auditor, and where it considers it neither prudent nor necessary to implement recommendations, provide reasons. Aurizon Network has clarified that this explanation will be given to the QCA and the Chair of the Rail Industry Group.<sup>144</sup>

Where end users and Aurizon Network are unable to reach agreement on the appointment of a suitably qualified auditor within 30 business days after the approval date, the QCA will appoint a suitably qualified auditor to undertake the compliance monitoring activity.

#### Changes to audit cost recovery obligations

Aurizon Network's proposal includes amendments as to how audit costs will be recovered. The existing UT5 Undertaking arrangements require costs for complying with audit obligations to be recovered through the adjusted allowable revenue obligations in Schedule F. The proposed amendments in the UT5 DAAU provide for the separate treatment of costs incurred by Aurizon Network and the auditor. While it is proposed Aurizon Network's costs continue to be recovered through the adjusted allowable revenue obligations in Schedule F, the auditors costs are to be borne by the party requesting the audit (either the QCA or end users). However, in all cases, where the audit identifies material non-compliance, it is proposed that costs will be borne by Aurizon Network and not recoverable through the adjusted allowable revenue provisions in Schedule F.

#### QCA analysis and preliminary position

We are currently minded to approve the amendments to Part 10 as outlined in the Revised UT5 DAAU. An effective reporting, compliance and audit regime provides transparency and accountability regarding Aurizon Network's below-rail operations, allowing for confidence in the regulatory regime. We consider that the proposed requirements provide appropriate information for stakeholders to make informed decisions. They also provide sufficient transparency and oversight of network performance, Aurizon Network's compliance with the undertaking, and its commitment to non-discriminatory behaviour.

The proposed monthly network performance reports include information similar to the existing quarterly network performance reports. These reports will also provide transparency and accountability in relation to the impact of maintenance work on supply chain users, which is currently addressed through the existing conditional maintenance performance report. Aurizon Network has confirmed that the QCA may publish a redacted version of the monthly report. This will provide transparency to all stakeholders.<sup>145</sup>

While the new monthly network performance reports do not include information captured in the annual maintenance plans or quarterly and annual maintenance reports, we currently consider it reasonable to remove these reports. We consider that a range of maintenance information will be provided through the new maintenance obligations discussed in section 1.2 of this paper. Aurizon Network has confirmed that the QCA will be able to publish any approved

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<sup>144</sup> Aurizon Network, Response to QCA RFI question 63, 23 July 2019, p. 18.

<sup>145</sup> Aurizon Network, Response to QCA RFI question 65, 23 July 2019, p. 18.



maintenance strategy and budget and Aurizon Network's maintenance cost claims.<sup>146</sup> This will ensure transparency is provided to all stakeholders, not just those who participate in the Rail Industry Group.

We are currently minded to approve the proposed audit obligations, although we are considering the practical implications of the QCA appointing the auditor under clause 10.6.4(b).

Aurizon Network has clarified that the auditor appointed to assess Aurizon Network's compliance with its maintenance objectives will be engaged for the specific audit (not an ongoing appointment) and, as such, will not be subject to a right of removal.<sup>147</sup> We consider this reasonable.

Changes to the recovery of audit costs should provide appropriate incentives to ensure that audits are requested and undertaken if there is concern regarding Aurizon Network's compliance with the undertaking. Where the QCA is required to bear the audit costs, it is our understanding that these costs will be recovered through the QCA Levy. We consider this appropriate, given that we would be requesting a compliance monitoring activity.

In its submission, Pacific National considered that the role of all supply chain participants be incorporated into the Independent Expert's consultative and decision making processes, including monthly reporting obligations, business rules underpinning the root cause analysis of performance trends and the development of performance metrics.<sup>148</sup>

We note that the existing UT5 Undertaking does not require consultation with supply chain participants in the development of reports and performance metrics.

Aurizon Network's UT5 DAAU proposal clearly sets out the performance metrics which must be included in reports provided by the Independent Expert. As discussed above, these include the performance metrics similar to those required under the existing UT5 Undertaking. In undertaking the required root cause analysis, the Independent Expert must have regard to a specific set of information provided by Aurizon Network.<sup>149</sup>

We consider that the proposed requirements around performance metrics, including the root cause analysis to be undertaken, should deliver sufficiently detailed and robust reports to provide transparency on Aurizon Network's below-rail operations to all supply chain participants. As such, we do not consider that Pacific National and other supply chain participants will be worse off compared to existing arrangements.

### 5.3 Voting rights and the Rail Industry Group proposal

Aurizon Network's UT5 DAAU proposal requires engagement with stakeholders on a number of decisions. These include approval of the maintenance strategy and budget, appointment of the Independent Expert, and conducting an audit of Aurizon Network's compliance with its maintenance objectives.

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<sup>146</sup> Subject to compliance with confidentiality obligations. Aurizon Network, Response to QCA RFI question 46, 23 July 2019, p. 15.

<sup>147</sup> Aurizon Network, Response to QCA RFI question 62, 23 July 2019, p. 17.

<sup>148</sup> Pacific National, sub. 22: 3.

<sup>149</sup> We note that the UT5 DAAU proposal requires the Independent Expert have regard to different sets of information depending on whether it is the aggregate monthly report (cl. 10.6.3) or the individualised monthly report (cl. 10.6.4). Aurizon Network considered this appropriate given the different circumstances. Aurizon Network, Response to QCA RFI question 67, 23 July 2019, p.18.

In order to facilitate engagement, Aurizon Network's proposal introduces a Rail Industry Group (7A.11.2). Aurizon Network has requested revisions to its UT5 DAAU so that all end users, access seekers and railway operators that hold contractual rights to provide train services will be invited to attend and participate in meetings of the Rail Industry Group.<sup>150</sup> Aurizon Network's proposal does not provide any additional detail on the operation of the Rail Industry Group.

While Aurizon Network will consult with the Rail Industry Group, where a decision is put to a vote, only end users will participate. Each voting end user is assigned voting rights based on their access rights — specifically, the highest volume of the end user's access rights in any year over a defined five year forecast period, divided by the aggregate amount for all end users. The Independent Expert is to calculate the voting rights (cl. 7A.11.8).

The table below outlines the range of voting thresholds included in Aurizon Network's UT5 DAAU proposal. Different thresholds apply depending on what decision is being made. Where a majority of end users or a special majority of end users is required, the UT5 DAAU proposal includes alternative threshold requirements for situations where the original threshold requirement cannot be met.

Obligations in Aurizon Network's UT5 DAAU proposal can require the approval of a special majority of end users in a specific coal system. In this case, the calculation of end user voting rights will be based on the end user access rights in the relevant coal system only. In addition, the thresholds associated with a special majority of end users must be met within the relevant coal system.

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<sup>150</sup> Aurizon Network, Response to QCA RFI question 21, 23 July 2019, pp. 6–7.

**Table 3 Voting thresholds**

<i>Type of threshold</i>	<i>Threshold requirements</i>	<i>Alternative threshold requirements<sup>151</sup></i>	<i>Decisions subject to majority vote</i>
Audit majority of end users	A number of voting end users that in aggregate hold at least 35% of the voting rights held for the year	n/a	Decisions relating to the audit of Aurizon Network's compliance with its maintenance objectives.
Majority of end users	A number of voting end users that in aggregate hold at least 60% of the voting rights held for the year	At least 50% of voting end users by number at the relevant time; and A number of voting end users that in aggregate hold at least 50% of the voting rights held for the year	Decisions relating to ring-fencing, the Reset Schedule F Values, appointment of the Independent Expert, rebate objectives and reporting.
Special majority of end users	A number of voting end users that in aggregate hold at least 75% of the voting rights held for the year	At least 60% of voting end users by number at the relevant time; and A number of voting end users that in aggregate hold at least 60% of the voting rights held for the year	Decisions relating to the Independent Expert, approval of maintenance and renewal strategies and budgets and submission of an end user DAAU.

### QCA analysis and preliminary position

Pacific National considered that all supply chain participants should be provided with the opportunity to be involved in the development of the scope, constitution and governance arrangements that will apply to the Rail Industry Group during the term.<sup>152</sup>

New Hope Group raised concerns in relation to how Rail Industry Group arrangements could impact access seekers and small users, noting that access seekers don't have voting rights and smaller producers were likely to have very limited ability to influence voting.<sup>153</sup>

With regard to the Rail Industry Group, we note that Aurizon Network has requested revisions so that end users, access seekers and railway operators may become members. Aurizon Network has also clarified that membership of the Rail Industry Group is not limited to coal-carrying train services. As such, non-coal users may become members.<sup>154</sup>

We note that the Rail Industry Group is simply a body to facilitate consultation between relevant parties, it is a forum rather than a decision making body. Ultimately, it is end users who will vote on decisions. Aurizon Network stated that voting power is vested in end users, as to grant voting power to railway operators, access seekers and customers of access seekers would provide a disproportionate say to a group of stakeholders who may not use the network or are essentially holding access rights on behalf of customers.<sup>155</sup>

<sup>151</sup> To be considered where the original threshold requirement is not satisfied.

<sup>152</sup> Pacific National, sub. 22: 3.

<sup>153</sup> New Hope Group, sub. 23: 2.

<sup>154</sup> Aurizon Network, Response to QCA RFI question 21, 23 July 2019, p.7.

<sup>155</sup> Aurizon Network, Response to QCA RFI question 21, 23 July 2019, pp.6–7.

While the definition of end user captures non-coal users,<sup>156</sup> it remains unclear whether Aurizon Network intends for non-coal users to have voting rights.

We accept that the use of contracted tonnages to determine voting rights is an appropriate approach (as proposed in the Revised UT5 DAAU).<sup>157</sup>

We seek stakeholder views on voting rights proposed in Aurizon Network's UT5 DAAU proposal. While New Hope Group has questioned the proposed voting arrangements, we note that a diverse and overwhelming number of coal producers have supported the proposed voting thresholds.

The views of stakeholders on this matter will assist us in making our forthcoming decision.

## 5.4 End user DAAU mechanism proposal

Aurizon Network's proposal includes a new mechanism to require Aurizon Network to submit a DAAU that is prepared by end users (cl. 12.6) under certain circumstances.

This mechanism will only apply where there has been a material change in circumstances (as defined under cl 12.6(b)) that will have a material adverse impact on more than one end user. It also cannot relate to specified aspects of the undertaking, including the WACC, the processes for determining operation and maintenance costs, and the dispute resolution processes (cl. 12.6(a)(v)). A special majority of end users across all coal systems<sup>158</sup> must vote in favour of the submission of the DAAU to the QCA before Aurizon Network will submit the DAAU (cl. 12.6(a)(viii)).

### QCA analysis and preliminary position

We are minded to approve Aurizon Network's proposed inclusion of this end user DAAU mechanism as outlined in the Revised UT5 DAAU. We understand the inclusion of this mechanism is the product of negotiations between Aurizon Network and its customers that negotiated the development of Aurizon Network's UT5 DAAU. On this point, Aurizon Network said the matters listed in clause 12.6(a)(v) are matters which the parties agreed should be not subject to re-opening through the end user DAAU process.<sup>159</sup> We note that any end user DAAU submitted by Aurizon Network will be subject to assessment by the QCA in accordance with the requirements under the QCA Act.

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<sup>156</sup> Aurizon Network, Response to QCA RFI question 20, 23 July 2019, p.6.

<sup>157</sup> Aurizon Network, Response to QCA RFI question 3, 17 September 2019, p.1.

<sup>158</sup> That is, a number of voting end users that in aggregate hold at least 75% of the voting rights or, if not satisfied, at least 60% of voting end users by number and a number of voting end users that in aggregate hold at least 60% of the voting rights.

<sup>159</sup> Aurizon Network, Response to QCA RFI question 71, 23 July 2019, p. 18.

## APPENDIX A: LIST OF SUBMISSIONS

We have received the following submissions during our investigation of Aurizon Network's UT5 DAAU. The submission numbers below are used in this report for referencing purposes. The submissions are available on the QCA website unless otherwise indicated.

<i>Stakeholder</i>	<i>Submission</i>	<i>Sub. number</i>	<i>Date submitted</i>
Aurizon Network	Aurizon Network 2019 Draft Amending Access Undertaking, Introduction to the 2019 Draft Amending Access Undertaking, 3 May 2019	1	3 May 2019
Aurizon Network	UT5 DAAU - Aurizon Network, Corrs and HSF - Meeting with QCA (presentation)	2	21 May 2019
Aurizon Operations Limited	Letter of support	3	3 May 2019
Aurizon Holdings Limited	Letter of support	4	3 May 2019
Anglo American Metallurgical Coal Pty Ltd	Letter of support	5	May 2019
BHP Mitsui Coal, Minerals Australia	Letter of support	6	May 2019
BHP Mitsubishi Alliance	Letter of support	7	May 2019
Byerwen Coal (QCoal Group)	Letter of support	8	May 2019
Ensham Resources	Letter of support	9	May 2019
Hail Creek Coal Holdings (Glencore)	Letter of support	10	May 2019
Jellinbah Mining (Jellinbah Group)	Letter of support	11	May 2019
Kestrel Coal Resources	Letter of support	12	May 2019
Lake Vermont Resources (Jellinbah Group)	Letter of support	13	May 2019
Middlemount Coal	Letter of support	14	May 2019
Peabody Energy Australia	Letter of support	15	May 2019
Peabody Energy Australia PCI (C&M Management)	Letter of support	16	May 2019
QCoal Infrastructure (QCoal Group)	Letter of support	17	May 2019
Yarrabee Coal Company (Yancoal)	Letter of support	18	May 2019
Coronado Curragh	Letter of support	19	May 2019
Adani Mining	Letter of support	20	11 June 2019
Gladstone Ports Corporation	Submission on UT5 DAAU	21	3 July 2019
Pacific National	Submission on UT5 DAAU	22	3 July 2019
New Hope Group	Submission on UT5 DAAU	23	3 July 2019
Rio Tinto	Submission on UT5 DAAU	24	3 July 2019