

# UT5 DAAU

**Aurizon Network, Corrs and HSF – Meeting with QCA**

21 May 2019



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# OVERVIEW

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# BACKGROUND

- The UT5 DAAU is the result of a detailed consultation and negotiation process undertaken by Aurizon Network (Aurizon) over a period of almost 12 months
- The UT5 DAAU provides a “package deal” of amendments that, if approved, will deliver a range of material benefits to Aurizon and its customers, including
  - greater customer involvement and collaboration in assessing and preapproving strategies and annual budgets for maintenance and capital expenditure
  - greater certainty for all stakeholders allowing for long term investment decisions
- Aurizon has ensured throughout the consultation process and in the final form of the UT5 DAAU, the interests of all end users, Access Seekers, Access Holders and Train Operators were protected and appropriately represented in the measures introduced by the DAAU.
- Aurizon signed Implementation Deeds with customers, representing more than 90% of the total railed coal tonnes in the Central Queensland Coal Network (CQCN), before submitting the UT5 DAAU to the QCA on 3 May 2019.

# OVERVIEW

- Term of UT5 to be extended to 30 June 2027
- UT5 Final Decision applies from July 2017 until DAAU is approved by QCA
- Stronger ringfencing obligations
- Re-baselining of capacity by an Independent Expert (**IE**) to reflect how the CQCN operates in practice
- Greater customer involvement and collaboration in assessing and pre-approving strategies and annual budgets for maintenance and capital expenditure
- WACC increase to 5.9% with effect from 3 May 2019, rising to 6.3% on completion of initial capacity assessment report, with certain market based parameters to be reset on 1 July 2023
- Aurizon will fund expansions to address any network capacity deficits identified in the initial capacity assessment up to \$300m
- Aurizon will be obliged to fund up to \$30m annually for expansions to create new capacity where it would benefit more than one access seeker
- Supply Chain Coordination Model proposal to be developed by Access Holders, Customers, railway operators, port operators and Aurizon Network

# KEY REVISIONS TO UT5

- ***Stronger ring-fencing obligations***
  - The UT5 DAAU provides new obligations with respect to independent management and governance for as long as Aurizon remains vertically integrated, including:
    - Independent observer to be appointed by Aurizon to attend Board meetings of Aurizon Network and provide a report to the QCA every 6 months on compliance with ringfencing obligations and good corporate governance
    - End User engagement and approval of transfer of senior and key Aurizon personnel to a Related Operator (and vice versa)
    - Execution of undertakings by all directors and specified senior and key personnel of Aurizon Network
    - Annual ringfencing compliance declaration signed by Aurizon Network's Executive Officer and the other member of the senior management team directly responsible for ensuring compliance with the ringfencing arrangements

# KEY REVISIONS TO UT5

- ***Certainty of contracted access and re-baselining of capacity***
  - IE to determine existing network capacity and reassesses on an annual basis
  - Capacity of each coal system to be assessed based on a dynamic model that reflects how each coal system operates in practice
  - Capacity model developed by the IE to be used for all future access applications
  - Initial capacity assessment report to determine “Deliverable Network Capacity” and thereafter annual capacity assessments to be completed by IE with initial capacity modelling to be undertaken by the ILC
  - At the same time the IE will develop System Operating Parameters for each coal system having regard to which it operates in practice
  - If the initial capacity assessment shows a deficit, Aurizon must propose solutions to effectively and efficiently address the shortfall which can then either be agreed with industry or become the subject of a recommendation by the IE to the QCA

# KEY REVISIONS TO UT5

- ***Rebate Mechanism***
  - Rebate payable to Customers where Aurizon performs below target levels
  - If requested by an End User at least 30 days prior to 13 January 2023, the QCA will review whether the rebate mechanism has been effective, measured against the defined Rebate Objectives
  - If the QCA determines, after conducting the review, that the Rebate Objectives have not been met in a material way then the QCA may recommend changes to the Undertaking in order to ensure that the Rebate Objectives are achieved.
  - If Aurizon does not agree with the QCA's recommendation, then Aurizon and the customers will seek to agree appropriate modifications to the rebate mechanism, failing which the WACC will be reduced by 30 basis points and the rebate mechanism will be removed from the Undertaking.

# KEY REVISIONS TO UT5

- ***Maintenance objectives***
  - A clearer and more objective statement of operational delivery and maintenance obligations by placing an obligation on Aurizon to comply with defined “Maintenance Objectives” which includes the delivery of committed capacity, balancing the costs/reliability and performance of the rail infrastructure and coordination of maintenance work across the supply chain in a way that minimises disruption to train services
  - An obligation to plan and undertake maintenance and operations in a manner consistent with any Maintenance Strategy and Budget approved by industry and otherwise having regard to the System Operating Parameters.

# KEY REVISIONS TO UT5

- ***Maintenance & Asset Renewals approval and cost recovery***
  - Aurizon to annually submit proposed Maintenance Strategy and Budget and proposed Asset Replacement and Renewals Strategy and Budget to newly established industry body called the Rail Industry Group (RIG) (similar to the Rail Capacity Group (RCG) in NSW) for approval by 30 November of the financial year prior to which the relevant expenditure will be incurred
  - The Maintenance Strategy and Budget will represent the allowance to be provided in the MAR for the following financial year
  - Aurizon to annually submit to the QCA for approval a proposed Maintenance Indicator and a proposed Capital Indicator in line with the Maintenance Strategy and Budget and Asset Renewals Strategy which has been discussed with the RIG:
    - If approved, Aurizon must implement both Strategies and Budgets
    - If the draft Maintenance Strategy and Budget is not approved by the RIG, Aurizon will submit its proposal to the QCA for approval
    - If the draft Asset Replacement and Renewals Strategy and Budget is not approved by the RIG, Aurizon will implement its final draft Strategy and Budget and seek approval of its costs from the QCA after the financial year end in the same way it currently does under the renewals capex claim process

# KEY REVISIONS TO UT5

- ***Maintenance & Asset Renewals approval and cost recovery***
  - A clear process for approval by QCA of maintenance costs and capital expenditure, including right of end users to make submissions
  - In the event there is a material difference in costs from the Approved Maintenance Strategy and Budget, the QCA will be able to consult and assess these variations for prudence and efficiency.
  - At the end of the year Aurizon will submit to the QCA its Asset Replacement and Renewal capital claim. Aurizon will, through the annual review of reference tariffs, repay or recover from industry the revenue amount by which the Allowable Revenue associated with the QCA approved capital amount is less than or exceeds (respectively) the 'capital indicator'.

# KEY REVISIONS TO UT5

- ***Expansions***
  - Aurizon to provide a commitment, in addition to renewals capital expenditure, of \$30m per annum (indexed to inflation) for expansions to create new capacity where it would benefit more than one End User with any unspent amount in a year to be accumulated forward to the next financial year
  - Aurizon will fund expansions to address any network capacity deficits identified in the initial capacity assessment up to \$300m.
  - If funding above \$300m is required for such expansions, this could be provided by Aurizon at its election.
  - Any amounts spent on these expansions will form part of the RAB and earn the applicable rate of return.
  
- ***Improved reporting and audit provisions***
  - Greater audit rights for QCA or special majority of end users
  - More comprehensive performance reporting obligations (in relation to supply chain coordination and maintenance work), including identification of system losses and causes.
  - Existing quarterly and annual maintenance cost reporting replaced with monthly network performance reporting through the Independent Expert

# KEY REVISIONS TO UT5

- ***End User DAAU***
  - Customers to have right to prepare an End User DAAU where requested by a specified threshold of customers (Special Majority).
  - The End User DAAU must relate to a material change in circumstance that has arisen post the approval date of the UT5 DAAU which will result in a material adverse impact on more than one End User.
  - Where these conditions are met, Aurizon must submit this End User DAAU to the QCA confirming that it has no objections to the QCA considering the matters within the End User DAAU.
- ***Supply Chain Coordination Model***
  - Aurizon to initiate and participate in the design and development of a proposal for an independent body to coordinate coal chain operations

# APPROVAL CRITERIA UNDER S.138(2) OF THE QCA ACT

## Objects of Part 5

- End user involvement
- Independent expert
- Existing deficits to be addressed
- Rebates
- 10 year term
- Expansions
- Staged increase of WACC

## Legitimate business interest of Aurizon Network

- Longer term security of revenue
- Rate on investment commensurate with risks

## Public Interest

- Extensive benefits provided
- Greater end user involvement
- Facilitating end users to be competitive

## Pricing Principles

- ability to earn requisite revenue and rate of return as required by s.168A(a);
- comprehensive and enhanced ringfencing, audit and compliance obligations;

## Pricing Principles (cont'd)

- mechanisms to reduce costs and improve productivity (e.g. with respect to Maintenance Strategies and Budgets)

## Interests of access seekers and access holders

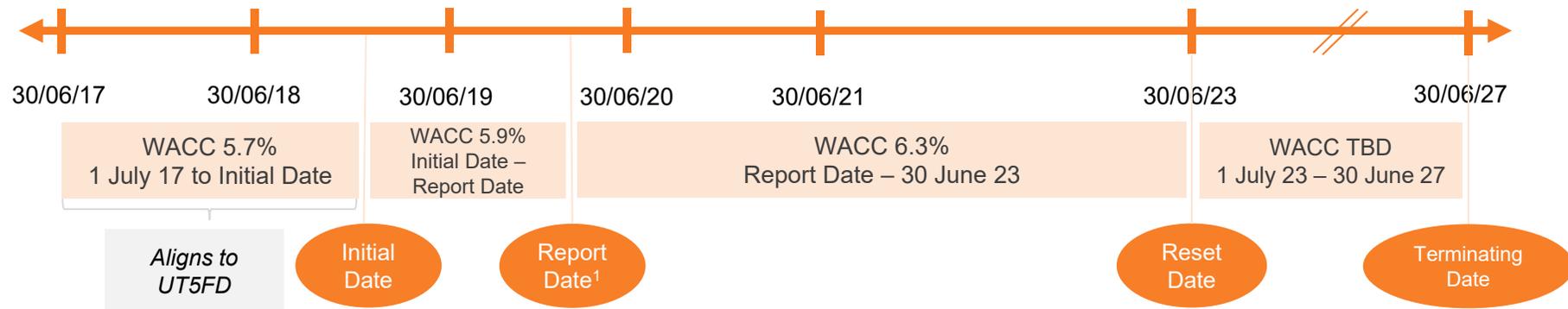
- Enhanced ringfencing, compliance and reporting obligations
- Rebate
- Direct involvement of the RIG which is open to all End Users

# APPENDICES – KEY TIMELINES



# WACC TIMELINE

## Staged WACC increase<sup>1</sup>



### MILESTONE

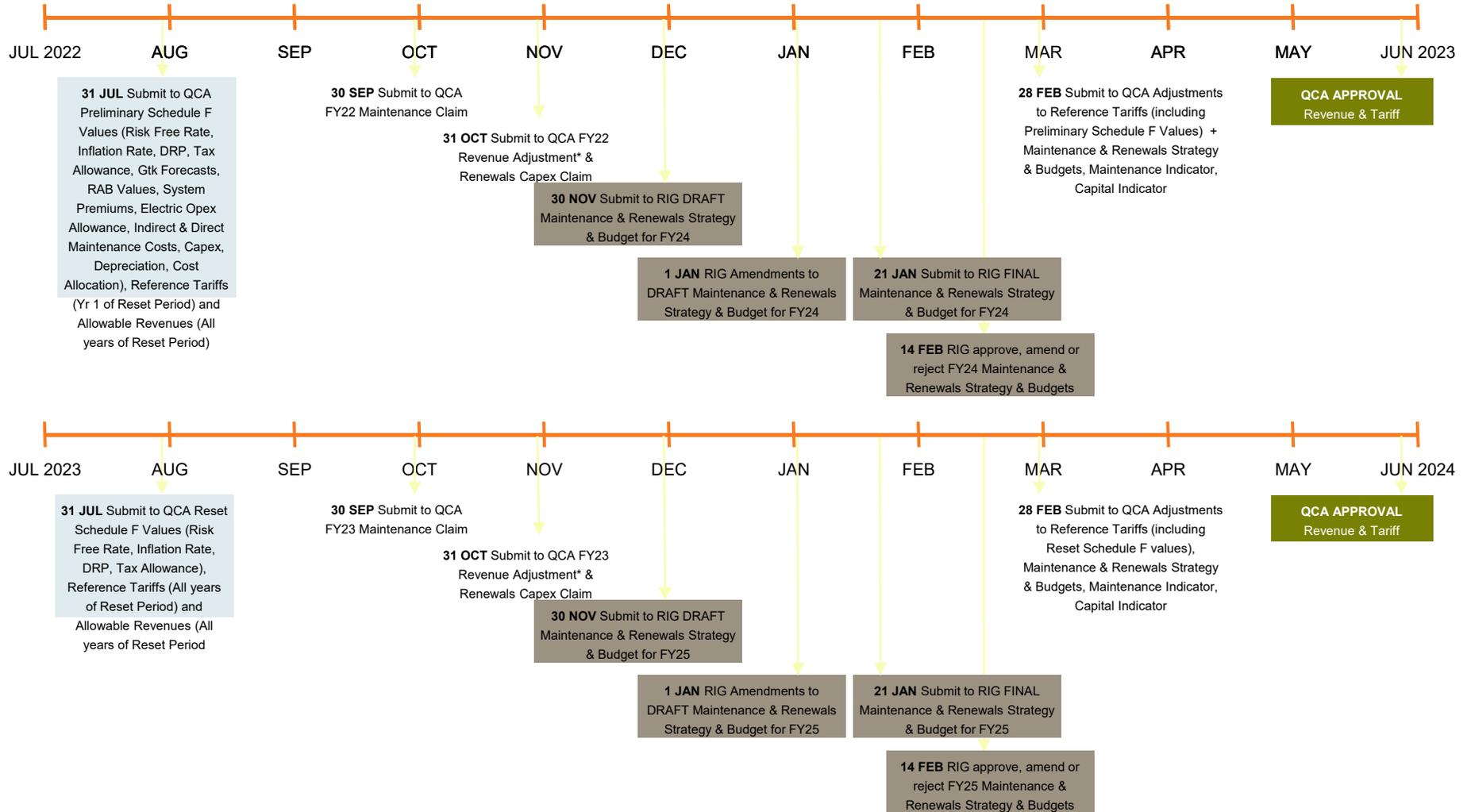
### DETAILS

Initial Date	Being the date on which the DAAU is submitted to QCA for approval
Report Date	<p>Date on which the later of the following events occur:</p> <ul style="list-style-type: none"> <li>› IE provides Initial Capacity Assessment Report (ICAR); and</li> <li>› Aurizon notifies relevant parties of proposed options to address Existing Capacity Deficits identified in ICAR.</li> </ul> <p>Where ICAR does not identify any Existing Capacity Deficits the Report Date is the date on which the IE provides the ICAR</p>
Reset Date	1 July 2023 (Reset of risk free rate, debt risk premium and inflation – methodology agreed)

<sup>1</sup> Best estimate of the milestone date – subject to change

\* WACC can be reduced as per the Rebate review mechanism

# TIMELINE FOR FY22 AND FY23 OUTLINING APPROVAL PROCESS (MAINTENANCE, ASSET RENEWALS STRATEGIES AND BUDGETS AND WACC RESET)



\* Revenue adjustment to account for, but not limited to, approved WACC, maintenance, Non-electric OPEX, Electrical traction costs, costs of audits, costs associated with any Conditions Based Assessment, costs for ground penetrating radar measurement, rebates, capital carryover, any other costs relating to, or arising out of compliance with this Undertaking that were not allowed for in the determination of the relevant Reference Tariff

QUESTIONS?

