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26 March 2021

Mr George Passmore
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane QLD 4001
by email: george.passmore@qca.org.au
via Submission process at: www.qca.org.au

Dear George,

[REDACTED]

**Aurizon Network – Maintenance Strategy and Budget – Newlands FY22
Submission Re: Rail Grinding Costs**

We refer to the Queensland Competition Authority's ("QCA's") request for submissions on the Newlands System FY2022 Maintenance Strategy and Budget ("MSB"). We have participated in the preparation of and provided support for the submission on this subject by the Rail Industry Group ("RIG"). Glencore provide this additional submission to further convey our concerns and detail the further investigations we request the QCA to undertake regarding the rail grinding business. This submission is marked confidential because information contained in this submission has been provided privately by Aurizon Network to Glencore or to the RIG. Glencore will copy this letter to Aurizon Network. Should Aurizon Network agree to this information being released publicly, Glencore provide its approval to the QCA to release this letter as a public submission.

As notified to Aurizon Network, the Glencore entities did not support the proposed FY22 MSB in any Central Queensland Coal Network ("CQCEN") systems it voted, due to concerns regarding the sale and contracting of the rail grinding business. We have engaged with Aurizon Network to better understand the circumstances surrounding the sale of the rail grinding business to Loram. Despite this engagement, we remain concerned as to the prudence and efficiency of the arrangement, in particular the apparent conflict of interest.

Sale of the Business

Glencore is concerned the sale of the business provides an inefficient windfall gain to the Aurizon group at the expense of the users of the Network. As Aurizon had received a return on and of the grinding assets historically, the QCA had previously indicated it would not be efficient to sell these assets. Glencore is concerned that the grinding service contract was entered into with a related party at an inefficient cost under a sole sourcing arrangement where Aurizon Network bears no risk, due to the pass through nature of the regulatory arrangements.

Glencore believe entering into the contract for the supply of rail grinding services at or around the time of sale to a third party was for the principle purpose of inflating the value of the rail grinding business for the broader Aurizon group. It is a failure of good corporate governance for Aurizon Network to commit to approximately \$ [REDACTED] million of expenditure (Glencore estimate [REDACTED]) on behalf of the customers via a transaction [REDACTED]

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██████████ using a sole-sourcing process approved under the delegated authority of the former head of Aurizon Network. Glencore do not believe the ██████████ into FY22 reflects a genuine change in underlying cost, and we believe instead that it is designed to achieve a higher price for the sale of the business. The impact of the price rise is further exacerbated considering the material increase to rail grinding scope going forward, further inflating the price received for the business.

Historical Ownership & Returns

From our investigation, it appears Aurizon Network have been purposely vague around the legal ownership and control of mechanised maintenance assets, whereas upon the sale of the rail grinding business, Aurizon have subsequently sought to use the actual legal ownership in an attempt to separate the profit on the sale from its own regulatory revenue.

Aurizon Network have confirmed the rail grinding assets and employees have always been owned by Aurizon Operations Limited (Aurizon Operations). Notwithstanding the legal structuring, it seems clear to us that the effective control of the activity was with Aurizon Network under the titles such as “QR Services”, “Network Services” and the “Specialised Track Services” group. Further confusing the issue has been Aurizon Network’s regulatory allowance for this activity under UT3 and UT4 being based on a return on assets plus depreciation approach, consistent with asset ownership.

Glencore have come to understand:

- In 2013 a restructure was implemented to better align resources between the regulated and non-regulated Aurizon entities resulted in the “Specialised Track Services” group reporting through to Aurizon Operations. While all other mechanized rail maintenance plant were leased to Aurizon Network from this time, the rail grinding assets ██████████. We note separating regulated and non-regulated in this manner is not consistent with other arrangements for non-regulated revenue Aurizon Network receives; and
- During ██████████ other mechanized rail maintenance plant (ballast cleaning and resurfacing plant) were transferred from Aurizon Operations to Aurizon Network at net book value (after the customers had contributed to the depreciation of these assets previously when owned by Aurizon Operations). Rail grinding assets were not transferred at this time. These assets have subsequently been determined to be ‘non-core’ for Aurizon Operations and consequently sold for a considerable uplift on their book value. It is unsurprising that Aurizon Operations would deem this activity as non-core, given the history of the activity being managed and operated by the Network business.

The decision not to transfer rail grinding assets to the Network business ██████████ appears to be a strategic one. It has enabled Aurizon to effectively change the approach to returns on the assets, after the QCA determined outsourcing was inefficient in 2014. As a result Aurizon has made a significant windfall gain at the expense of its customers by selling an asset that had always been historically managed by Network and had its depreciation paid for by its customers. It has then hid behind the strict legal asset ownership by its related entity. Looking through this construct, it would be reasonable to attribute a large portion on the gain on sale to Aurizon Network (being the CQCN portion) and consequently reducing Aurizon Network’s regulatory allowance from customers.

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QCA Investigation

Glencore request the QCA thoroughly investigate the rail grinding business history, allowances and costs. In addition to the requests made by the RIG, Glencore would appreciate the QCA undertake the following:

- Review the historical legal ownership of the rail grinding assets, the construct of allowances paid by customers under various undertakings and consider this in the context of Aurizon Operations selling the business for a significant gain via price rises not supported by underlying costs;
- Determine how any historical non-CQCN activities undertaken by the rail grinding assets (e.g. for Queensland Rail) was accounted for as far as whether by proportionate reduction of the charges to Aurizon Network's customers or as a reduction to regulated revenue of the CQCN, as well as the appropriateness the method chosen;
- Review any other information available to determine whether the sale transaction or other events around that time involved any actions by the Aurizon group that adversely effected Network's customers; and
- Determine whether Aurizon Network undertook appropriate market testing when entering into a [REDACTED] service contract with a business that a related party stood to make a significant gain on.

Glencore are concerned Aurizon Network's actions on rail grinding will set a precedent for both future Aurizon Network transactions as well for other monopoly service providers to extract inefficient returns from their customers.

With the information available to date, Glencore can only conclude that Aurizon has used its monopoly supply position to extract excess rent from its customers and has used its vertically integrated structure to retain this monopoly rent outside of the regulatory structure. We request the QCA to set an appropriate allowance for rail grinding cognisant of the historical context and charging approach, but importantly also provide appropriate protections from this type of construct occurring again.

Thank you for the opportunity to comment on the FY22 MSB. Should the QCA require, we would be happy to provide further input or discuss this issue in greater detail.

Yours Sincerely

[REDACTED]
Anthony Pitt
Glencore