

Aurizon Network's Submission in Response to the QCA's Draft
Decision (dated 1 September 2016) to Approve Aurizon Network's
Amended Draft Access Undertaking

23 September 2016



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1. Introduction

This submission responds to the QCA's draft decision dated 1 September 2016 (**Draft Decision**) to approve Aurizon Network's Amended Draft Access Undertaking (**ADAU**).

Aurizon Network supports the Draft Decision, and welcomes in particular the QCA's confirmation that the ADAU reflects the QCA's policy intention for the 2014AU (**UT4**), and that UT4 in turn is the product of the extensive and comprehensive consultation process. Further, the ADAU is also the product of consultation with stakeholders, and is as the QCA notes, consistent with the policy intent and decisions expressed by the QCA in the UT4 Final Decision. As the QCA notes in the Draft Decision, Aurizon Network intends to submit a DAAU, in the event the ADAU is approved, in order to seek to amend the (then) approved undertaking to reflect agreement reached with the QRC and reflected in the QRC submission on the ADAU dated July 2016.

The Draft Decision also addresses in detail a submission made by Glencore. The balance of this submission addresses the QCA's analysis of the Glencore Submission in the Draft Decision.

2. QCA analysis of Glencore submission

Aurizon Network agrees with the QCA's analysis of Glencore's submission, a submission which Aurizon notes is directly inconsistent with Glencore's previous submissions in relation to WIRP. The QCA notes at p9, that the Glencore submission represents an attempt "to use the current regulatory process to, in effect, revisit the appropriate regulatory treatment of a previously executed commercial agreement that it entered into in 2012, thereby in part negating the intended commercial effect of that agreement".

Aurizon Network agrees with the QCA. The Glencore Submission, if acted on, would have the effect of:

- > overriding a 20 year commercial agreement struck between sophisticated counterparties bargaining with ACCC authorisation, and on terms that were approved by the QCA;
- > creating a high degree of regulatory uncertainty, and unfairly and retrospectively altering the risks to which Aurizon Network and the users of WIRP were and are exposed;
- > prejudicing the legitimate business interests of Aurizon Network;
- > exposing Aurizon Network to unforeseen and adverse financial consequences;
- > entirely unwinding the basis on which Aurizon Network and the WIRP users made their investment decisions for the significant WIRP infrastructure which has been delivered and is operational; and
- > as a result, acting as a powerful disincentive for future investment in the facility operated by Aurizon Network – either by Aurizon Network or potential user funders.

The QCA's final decision for UT4 is – as the QCA notes - reflected in the ADAU. The issues now being raised by Glencore relate to WIRP pricing – however, it is clear that the status and effect of WIRP pricing was fully and appropriately considered by the QCA in arriving at its Final Decision for UT4. Accordingly, the QCA is correct in rejecting the Glencore submission and deciding to approve the ADAU.

Aurizon Network is not aware of (and does not believe there to be) any evidence to the effect that the regulatory treatment of the WIRP access conditions by QCA, as approved by QCA under UT3, was not intended to survive the expiry of UT3 or have any long-term effect beyond UT3. In fact the opposite is true.

2.1 Factual context

Glencore's submission must be seen in the relevant factual context, with which it is inconsistent.

(a) Glencore is one of eight WIRP users which signed a WIRP Deed that was approved by the QCA as an "access condition" under, and in accordance with, the relevant process in Aurizon Network's 2010 Access Undertaking (UT3).

(b) The WIRP Deed was an outworking of the following circumstances:

- (i) In the years preceding execution of the WIRP Deed, port capacity in Queensland had been constrained, while forecast demand for that capacity had increased.
- (ii) A group of interested parties (including Glencore, then Xstrata) therefore initiated the development of a new coal export terminal – what is now WICET.
- (iii) The creation of that port necessitated the expansion of the rail network in central Queensland, to facilitate the transport of coal from various mines to the new port (the WIRP project).
- (iv) The prospective users sought, and were granted, approval by the ACCC to collectively negotiate with Aurizon Network. They then approached Aurizon Network to provide the required expansion.
- (v) Aurizon Network was not obliged to construct the WIRP Project, but was willing to do so on commercially reasonable terms.
- (vi) That was because the scale of the proposed expansion (the construction cost of which was estimated at \$900m) was such as to expose Aurizon Network to significant financial risks in the delivery of it.
- (vii) The WIRP user group (including Glencore) acknowledged those risks and so agreed terms with Aurizon Network which included the payment of the WIRP Fee over a 20 year period.
- (viii) Those terms, and payment of the WIRP Fee over the full 20 year period provided, in aggregate, the agreed compensation for the undertaking by Aurizon Network of the financial risks which the network expansion – and its ongoing operation - entailed.
- (ix) In accordance with the terms of UT3, Aurizon Network submitted an Access Conditions Report to the QCA, seeking approval to impose the agreed terms as access conditions on parties seeking access to the expanded network.
- (x) The WIRP User Group, including Glencore, made submissions to the QCA in support of the WIRP Deed as part of the QCA's approval process.
- (xi) In its decision to approve the access conditions reflected in the WIRP Deed, the QCA expressly confirmed that one of the factors that it took into account was the support of the WIRP User Group for the WIRP transaction.

(c) The WIRP Deeds approved by the QCA

(d)

- (e) More particularly, the WIRP Fee is payable:
- (i) In consideration for Aurizon Network funding and delivering the Extension on time and within budget, to meet the WIRP users' needs; and
 - (ii) In recognition of the fact that Aurizon Network assumed significant risks in agreeing to fund and deliver the Extension. Aurizon Network provided a detailed description of those risks to the QCA in section four of its Access Conditions Report.
- (f) By way of comparison, the access charges are payable by the WIRP users:
- (i) To secure rights of access to the Extension (and associated infrastructure); and
 - (ii) Are commensurate with the usual regulatory and commercial risks incurred by Aurizon Network in providing those access rights.
- (g) Despite their separate and distinct nature, there is an underlying but important symmetry between the two payment obligations. [REDACTED]
- (h) Glencore is therefore correct in its submission that the *"WIRP Fee is a charge... levied proportionately to the access rights which are contracted for under the WIRP Deed"*. Each user's access rights are the agreed (and logical) reference point for the corresponding amount of their liability under the WIRP Deed. (Glencore describe this as a correlation.)
- (i) That there is a symmetry between users' access rights and their independent WIRP Fee liability does not, however, have the effect that the WIRP Fee (or any Optimisation Fee) comprises, or should be treated as, an access charge.
- (j) As Aurizon Network stated in its Access Conditions Report:
- [REDACTED]
- (k) Clause 13 of the WIRP Deed makes that point very clearly. [REDACTED]
- (l) Consistent with this, in a pleading filed by Glencore in Supreme Court proceedings (2880/16) concerning the proper construction of the WIRP Deed, it says (at paragraph 10(c)(iii) of its amended defence) that *"the WIRP Fee was payable in addition to the Access Charges payable by the Customers to Aurizon [Network] under the Access Agreements"*. It is notable that in these Supreme Court proceedings, Glencore is also seeking to avoid liability for the WIRP Fee, but on a different and conflicting basis to the one made to the QCA.
- (m) In any event, as is now well known, pursuant to its obligations under the WIRP Deeds, and on the basis of the QCA's approval of the proposed access conditions, Aurizon Network funded and constructed the new WIRP infrastructure, which is now being used by Glencore.

- (n) Aurizon Network has not yet issued an invoice to Glencore (or any user) for the WIRP Fee as the timing for the commencement of invoicing is still being determined. However, despite the fact that it now has and will continue to have the full benefit of Aurizon Network's investment, Glencore now submits that *"the revenue Aurizon Network is deriving from the fees payable under the WIRP Deed should be included in the application of the System Allowable Revenue test"*.
- (o) By making this submission, Glencore is effectively saying the QCA should invoke its regulatory powers to deprive Aurizon of the benefit of the further payments that Glencore (and the other WIRP users) agreed to provide to Aurizon over the remainder of the 20 year period, notwithstanding that Glencore remains able to continue to enjoy the ongoing benefits of the expanded network.
- (p) Aurizon Network's position is that Glencore:
 - (iii) mischaracterises the WIRP Fee as a de facto access charge (when it is clear from the above that it is not);
 - (iv) is making the submission in the absence of any genuine or relevant regulatory principle
 - (v) has not explained how the submission is consistent with its earlier submission to the QCA on the WIRP Deed (with which Aurizon Network agrees), namely that it did not support the use of current information:

"to second guess investment decisions which were committed to on the basis of the best information reasonably available at the time. To do so would be to introduce a high degree of regulatory uncertainty. In the case of WIRP, this would unfairly and retrospectively alter the risks to which the users of WIRP are exposed."; and
 - (vi) is seeking to achieve its goal by presenting different arguments to the QCA and the Supreme Court of Queensland.
- (q) Glencore's submission needs to be seen and assessed in light of the above.

2.2 Regulatory uncertainty

Aurizon Network entered into the WIRP Deeds in good faith and in reliance on their approval as an access condition by the QCA. The WIRP Deeds were fundamental to Aurizon Network's decision to invest in the WIRP infrastructure and to expand the rail network. Aurizon Network relied on the fact that the term over which the WIRP Fee was payable in addition to access charges was for a specified period of approximately 20 years – a period significantly longer than the regulatory period for UT3.

Aurizon Network is concerned that:

- (a) Glencore is seeking to further its commercial objectives by seeking to unwind the effect of the WIRP Deeds in a manner that fundamentally alters the financial basis of the transaction; and
- (b) Glencore's proposal would result in there being no regulatory certainty for any access agreement, user funding agreement or any other regulated contract (including contracts which will only be effective if approved by the QCA).

2.3 Access conditions were always intended to endure – as was the regulatory treatment.

In the Draft Decision (p9), the QCA invites stakeholders to provide any evidence to the effect that the regulatory treatment of the WIRP access conditions by the QCA, as approved by the QCA under UT3, was not intended to survive the expiry of UT3 or have any long-term effect beyond UT3.

Aurizon Network confirms it is not aware of any such intention, and indeed, the contrary intention is very clearly expressed in the WIRP Deeds and access agreements entered into by each of the WIRP customers – including Glencore.

Indeed, previous submissions in respect of the WIRP transaction made to the QCA by Glencore and the WIRP User Group exemplify an intention not only that the access conditions would survive the expiry of UT3, but would also continue – together with the regulatory treatment of the WIRP infrastructure – for future regulatory periods.

By way of example:

- (a) Letter from Glencore to the QCA dated 24 October 2014

“We would expect that this future decision by the QCA will be taken on the basis of the information which would have been reasonable (sic) available to Aurizon Network at the time of making its investment decision in relation to the WIRP assets, in accordance with the principles which apply under the current 2010 Access Undertaking and which are proposed to apply under UT4. To do otherwise would reflect a retrospective change in regulation which no reasonable regulator could make, particularly given the magnitude of the investments which have been made in reliance on the proper implementation of the current regulatory regime.”

“Glencore Coal does not support the use of current information to second guess investment decisions which were committed to on the basis of the best information reasonably available at the time. To do so would be to introduce a high degree of regulatory uncertainty. In the case of WIRP, this would unfairly and retrospectively alter the risks to which the users of WIRP are exposed.”

- (b) Letter from WIRP Users Group (representing WIRP Users including Glencore) to the QCA dated 6 February 2015, page 6:

“The WIRP Users acknowledge concerns raised by other stakeholders in relation to the impact of the WIRP expansions on their Train Services. However, it should be noted that the WIRP Access Conditions actually provide an incentive for AN to ensure it delivers the infrastructure that can sustainably deliver the full 108mtpa of contracted capacity into the Gladstone region, being both WIRP and non-WIRP tonnes. This incentive ensures that non-WIRP tonnes receive their full contracted tonnes, but it is underwritten by a top up payment in the WIRP Access Conditions (“WIRP Fee”) that is payable by the WIRP Users only...”

The WIRP Users acknowledge it was their decision to provide AN with a higher rate of return on the WIRP infrastructure, but do note that all users (and not just the WIRP Users) in the Blackwater and Moura systems will receive the benefit of the WIRP infrastructure which would not have been built if the WIRP Users had not agreed to pay the WIRP Fee.”

- (c) WIRP Users: Submission to the Queensland Competition Authority – Response to QCA’s Supplementary Draft Decision: Reference Tariffs for Wiggins Island Rail Project September 2015, page 48 and 49:

“By their very nature, infrastructure assets require considerable time to negotiate, design and construct. This can span years and span multiple regulatory periods, with train services at times beginning in a different regulatory period than when the asset was first conceptualised. WIRP is a prime example of this, with its inception; commercial acceptance; physical design; and the majority of its construction, mainly performed under the provisions contained in the 2010AU (‘UT3’).”

“firms make significant investment decisions with expectations that regulators will continue to apply regulation as previously administered:

Firms need to form expectations about the outcome of future regulatory decisions in order to evaluate the business case for investment projects. In forming these expectations, the firm will look to any past history of regulatory decision-making by the same people, and will update these expectations each time a new decision is observed. This learning process implies that regulatory uncertainty is highest, early in the tenure of a new regulator.⁴ (citing the ACCC)

The “retrospective application of the 2014DAU may discourage future investment into the CQCN given the uncertain investment environment this creates.

The WIRP User Group therefore believes that such regulatory positioning seriously threatens future investment within the CQCN; introduces unanticipated regulatory risk into the Queensland economy; reduces regulatory certainty which should be associated with infrastructure assets, especially those of national significance; and most importantly, reduces confidence into the efficacy of the regulatory environment under which the CQCN and its stakeholders operate.”

(d) WIRP User’s Submission to the QCA in response to the QCA’s UT4 Consolidated Draft Decision:

“...it is difficult to appreciate how a decision of a regulator within one period is not used to inform subsequent decisions. Without that, stakeholders operate within an environment void of certainty as there is no regulatory economic reference point. The WIRP User Group is of the view that the QCA should not create ambiguity by not respecting its previous decisions.” (page 3)

“The WIRP User Group continues to maintain that the WIRP Deeds between each of the constituents of the WIRP User Group and AN are commercial agreements designed to provide AN with an additional return, over and above the WACC, in consideration for incentives linked to the overall delivery of the project.” (page 7)

2.4 Glencore Analysis of UT4 Access Conditions Provisions

Glencore spends some considerable time in section 4 of its submission considering *“how the WIRP Deed terms would be analysed under the UT4 access conditions provisions”*.

That analysis is irrelevant. The QCA has not been asked to approve the WIRP Deed under UT4 (which is yet to be approved by the QCA). The QCA was asked to approve the WIRP Deed as an access condition under UT3. The access condition approval which the QCA gave for the WIRP Deed and the WIRP Fee under UT3 was not and can not be qualified as to time or regulatory period – as stated above it was an approval to enter into a binding, long term contractual arrangement that necessarily went beyond the regulatory period for UT3.

2.5 QCA has already considered the issues now being raised by Glencore

Glencore's submission incorrectly proceeds on the implication that the QCA did not have regard to the WIRP Deeds including WIRP Fees when making its reference tariff decisions for UT4.

The QCA clearly gave consideration to the full effect and meaning of the WIRP Deeds and the WIRP Fees in its supplementary draft decision on "Reference Tariffs for Wiggins Island Rail Project Train Services" (July 2015) and consequential consolidated draft decision and the final decision on UT4.

For example, the QCA stated in its supplementary draft decision:

- (a) *"it would not be appropriate to exclude consideration of the WIRP access conditions when forming our draft decision"* (page 12)
- (b) *"WIRP customers supported Aurizon Network's view that WIRP access conditions were not a relevant factor in determining the cost allocation, nor did their existence prevent capital costs being allocated to non-WIRP customers. Glencore said the asset stranding and optimisation risk to Aurizon Network would not be affected by socialisation. In addition, it said the credit risk addressed in the WIRP access conditions related to the recovery of the WIRP fee rather than general access charges."* (page 18)
- (c) *"In this instance, however, Aurizon Network and WIRP users agreed additional risks were involved in developing the WIRP project and that Aurizon Network should be compensated for this via access conditions (a WIRP fee). We consider this factor relevant in forming our view on which WIRP costs should be allocated to WIRP users."* (page 18)
- (d) *"In coming to this view we note both Aurizon Network and WIRP users have decided that it was in their individual interests to agree to the WIRP fee."* (page 18)

Glencore either independently or through the WIRP User Group made various submissions in relation to the reference tariffs that should apply under UT4. Glencore did not raise any of the matters it is now raising during the UT4 regulatory process when the QCA was considering the reference tariffs that should apply to Wiggins Island Port train services. Indeed, Glencore made supportive submissions which it now seeks to contradict.

2.6 What did the QCA approve?

The approval given by the QCA for the access conditions in the form of the WIRP Deeds was not just an approval in respect of the terms of the WIRP Deeds themselves, but an approval for the parties to enter into and be bound by those terms. Once the approval was given, it was effective in accordance with its terms and is permissive of the parties giving effect to the access conditions.

Without the QCA's approval, Aurizon Network would not have been lawfully entitled to give effect to the WIRP Deeds.

The QCA's approval of the WIRP Deeds expressly allows Aurizon Network to recover the WIRP Fee in addition to access charges over the term of the WIRP Deeds. Section 4 of Glencore's submission recites the provisions of the WIRP Deed that contain the express agreement of the parties as to the nature of the WIRP Fee.

Despite that express agreement in the WIRP Deeds and the QCA's consideration and approval of them, Glencore now invites the QCA to re-characterise the WIRP Deed and the WIRP Fee.

The QCA cannot ignore or re-characterise the WIRP Deed or the WIRP Fee as suggested by Glencore – they are the very things that the QCA has approved and they are contained in an existing, binding contractual agreement.

2.7 A matter of discretion

Glencore submits that “[t]he previous decision under the UT3 Access Undertaking does not legally fetter the QCA’s ability to decide how to treat this issue in UT4”.

Aurizon Network agrees that, as a general principle, the QCA has relatively broad regulatory discretion. However, a discretion should never be exercised to fundamentally alter the legal and financial effect of a fully negotiated and otherwise binding contractual agreement, especially one that has been the subject of an express approval by the QCA.

If the QCA were to exercise any such discretion in the manner proposed by Glencore, it would have far reaching consequences in relation to any QCA regulated contract and every approval given by the QCA. Parties could never rely on contracts or approvals entered into in accordance with the regulatory regime so as to justify investment decisions, if the QCA could fundamentally alter the basis and effect of the contract or approval. Such regulatory uncertainty would be inconsistent with the object of Part 5 of the QCA Act.

In considering Glencore’s submission, the QCA should also have regard to the fact that it has already made a final decision in respect of UT4 which took into account of the WIRP Deed issues in determining the reference tariff applicable to Wiggins Island Port train services and the fact that Aurizon Network has already submitted for approval a draft access undertaking which is consistent in all material respects with the requirements of the QCA’s final decision.

2.8 Conclusion

While we have many concerns with Glencore’s submission, we have articulated in this submission a number of fundamental issues with the Glencore submission. Accordingly, while we have not sought to address all of those concerns (nor matters raised by other stakeholders) in this submission, we would be happy to meet with the QCA to discuss Glencore’s submission in more detail if you feel it would be helpful to do so.

The concerns that we have raised in this submission are significant. Glencore’s proposal:

- > undermines the force and effect of the regulatory regime and contracts made consistent with it;
- > is inconsistent with its previous submissions to the QCA; and
- > raises matters that have already been considered by the QCA in its UT4 decisions.

The QCA is therefore entirely correct in its Draft Decision to reject Glencore’s submission, and to decide to approve the ADAU. This position should be reflected in the QCA’s final decision on the ADAU.

Please do not hesitate to contact Donna Bowman if you wish to discuss any aspect of this submission.