

STAKEHOLDER NOTICE

21 September 2018

Aurizon Network - UT4 compliance update

Summary

After Aurizon Network's announcements that it would introduce new maintenance practices from January 2018, the Queensland Competition Authority (QCA) sought information to assess Aurizon Network's compliance with the terms of its 2016 access undertaking (UT4). Aurizon Network claimed all information provided to the QCA in response to our requests and as part of the assessment was confidential and consequently, our analysis does not refer to the material provided, but refers to publicly available information.

Our analysis showed that network performance (in terms of net tonnes of throughput) has been more volatile in the period since January 2018, but there is limited evidence that overall throughput has been reduced by Aurizon Network's previously estimated figure of 20Mtpa. Sufficient train paths have been available on a monthly basis to meet contracted amounts.

From our initial assessment, while Aurizon Network appears to have met its obligations under UT4, it would appear that it introduced the changes without providing adequate time for supply chain participants to adapt to the new, less flexible, maintenance practices.

Our assessment of this matter is ongoing, and we intend to review our findings where new information or data becomes available.

Background

Earlier this year, Aurizon Network announced that it would change its operating and maintenance practices. As a result, in various public statements, Aurizon Network stated that it was expecting significant adverse impacts on CQCN throughput. Aurizon Network said that it implemented changes in response to the maintenance allowance and commercial returns proposed by the QCA's draft decision on the replacement access arrangements (UT5).

Aurizon Network's decision and the potential impacts on the supply chain (if they existed) are of significant concern to stakeholders and the QCA. The changes were announced and (presumably) implemented by Aurizon Network without consultation and with limited information published on the nature, impact and extent of the changes. Aurizon Network said that it estimated that the changes to maintenance practices could have the effect of reducing throughput by approximately 20Mtpa.

The QCA has a role in monitoring Aurizon Network's compliance with its regulatory obligations—in particular, the terms of its current approved access undertaking (UT4). We issued Aurizon Network with a compliance notice in March 2018 requesting information to enable us to assess whether Aurizon Network was complying with UT4.

In addition to the access undertaking, Aurizon Network has various other contractual, regulatory and legal requirements, including under access agreements with its customers, with which it must comply. Compliance with those obligations is a matter between Aurizon Network and its customers.

Response to the stakeholder notice

The QCA's March 2018 compliance notice set out matters forming the basis of our review. In response, we received information from Aurizon Network, the QRC, Pacific National and Aurizon Coal.

Aurizon Network claimed confidentiality over all of the information that it provided. The QCA has not, at this time, formally assessed the validity of that claim. However, in the interests of ensuring that the assessment of Aurizon Network's compliance was not delayed by these issues (in light of the obvious significance of this matter for stakeholders), the QCA has not published any of the submissions. We reserve the right to do so at a later stage should this be deemed necessary and after all confidentiality claims have been assessed.

In carrying out the assessment, the QCA has reviewed published system performance data to assess network performance and throughput impacts since the changes were introduced. Also, we have assessed and taken into account relevant information provided to determine whether Aurizon Network's actions constitute a breach of any part of the undertaking. We have taken into account all of the confidential material provided in submissions as well as responses provided on the QCA's maintenance matters paper released for comment in May 2018 as part of the UT5 DAU process.

Network performance and throughput impacts

In our March 2018 notice, we asked Aurizon Network to explain the significant impacts it anticipated would result from its changed maintenance practices. Aurizon Network provided information to us on a confidential basis, which has been reviewed.¹

Aurizon Network in various public statements said the changes to its operations would result in throughput loss expected to be ~20Mtpa. It said there was potential for greater impacts (if further operational changes were needed) and that the impacts would be felt broadly across the supply chain, with flow on effects to the Queensland economy. Aurizon Network provided a breakdown of impact by system: Goonyella: up to 10 million tonnes per annum (mtpa); Blackwater: up to 8 mtpa; Moura: up to 1.5 mtpa; and, Newlands: up to 0.3 mtpa.²

In addition, Aurizon Network explained that the impacts resulted from less operational flexibility. Aurizon Network maintained that in the past, operational practices maximised supply chain throughput by planning and executing activities with minimal supply chain throughput impacts. It said that its new approach, of strictly adhering to the scheduled time of planned possessions, does not account for the realities of managing a dynamic rail network, effectively causing throughput interruptions (due to the higher number and length of possessions).³

We recognise there are a range of supply chain factors that impact network performance. This makes it difficult to determine with reasonable certainty what the impacts on network performance (and throughput) are just from Aurizon Network's changed maintenance practices. Also, given the significant change is apparently to flexibility in the operational environment, stakeholders' ability to respond and adapt to the changes would need to be considered among the relevant factors (requiring an inherently more complex review).

The QCA's review has provided some transparency on network performance and throughput impacts since the new maintenance practices were said to be introduced by Aurizon Network (see **Attachment 1** for a more detailed summary).

Overall, network performance data⁴ shows greater volatility in monthly throughput levels since January 2018. Compared to preceding months, there was an initial drop in throughput in the Goonyella and Blackwater systems.

¹ This is not required, or relied on, for this network performance review. Relevant information is available in Aurizon Network's public performance and market reports.

² Aurizon Network, Update on CQCN capacity Impacts, March 2018

³ Aurizon Network (June 2018) Response to QCA on UT5 Maintenance, pp. 10, 21, 23-25.

⁴ Refers to the quarterly network performance reports published by Aurizon Network in line with UT4 reporting requirements.

Stakeholders have observed increased variations in the train scheduling environment⁵. They also raised concerns that Aurizon Network's decision to change practices was implemented immediately, and without any industry consultation⁶.

However, there is no evidence of a material and sustained reduction in throughput that would support Aurizon Network's impact estimates. Aurizon Holdings' end of 2018 financial year report highlighted that the Network business achieved record throughput of 229.6Mt for the year, with monthly records indicating the highest ever volume of 20.6Mt achieved in June 2018.⁷ This annual volume was only slightly below the originally forecast 231Mt. Further, volumes over the February-June 2018 period were broadly in line with the average monthly volumes since mid-2016 (excluding the April 2017 cyclone impact).

We also note Aurizon Network did not seek to reduce FY19 volume forecasts used to set the UT4 transitional tariffs recently – confirming 244Mt represented the most recent and reasonable forecast of volumes expected to rail during FY19.⁸ This amounts to an expected increase of around 15Mtpa compared to record throughput achieved in FY18.

Hence there is no evidence of a significant reduction in net tonnage throughput since the end of January 2018 that would be consistent with the previously estimated 20Mtpa reduction.

In addition, on a monthly basis, the QCA's analysis showed that sufficient train paths were available in each system to meet contracted train paths (**Attachment 1**).

That being said, it is acknowledged that our analysis is unable to ascertain whether the actual volumes would have been higher, but for the announced change in maintenance practices by Aurizon Network. For example, Aurizon Network indicated in its annual reporting that an additional 7-8Mt could have been railed in FY2018.

Compliance with UT4 requirements

In the March 2018 notice, the QCA sought relevant information from Aurizon Network on its compliance with a number of UT4 obligations, including:

- obligations not to prevent or hinder access (cl.2.3(c))
- requirements to provide 'Below Rail Services', including appropriate levels of maintenance, to ensure Aurizon Network is meeting its obligations to access holders and other relevant parties (cl.3.4(c))
- requirements to comply with and report on the network management principles in relation to scheduling, maintenance and providing capacity related information to access holders and train operators
- engagement with supply chain groups as to coordination of maintenance activities (cl.7A.3)
- general reporting obligations in relation to performance and compliance, including maintenance obligations (Part 10).⁹

⁵ Aurizon Coal (June 2018) Response to QCA on UT5 Maintenance, p. 2.

⁶ QRC (June 2018) Cover Letter of Submission in Response to QCA on UT5 Maintenance.

⁷ Aurizon Network Directors Report for the year ended 30 June 2018, p. 2.

⁸ Aurizon Network (April 2018) Extension DAAU at http://www.qca.org.au/getattachment/2f225855-9ffa-432c-b361-ed0bf09cd4b0/Aurizon-Network-April-2018-Extension-DAAU_submis.aspx [p. 5].

⁹ The QCA's March 2018 compliance notice can be accessed on the QCA's website at: <http://www.qca.org.au/getattachment/00c934a7-17b6-4226-99c9-24cc30a6057e/QCA-Capacity-impacts-of-maintenance.aspx>

Aurizon Network said the changes to its maintenance practices do not contravene any of its existing obligations under UT4 or individual access agreements. It also said concerns publicly raised by stakeholders on numerous occasions about potential impacts have not occurred.¹⁰

Obligations to provide below-rail coal services and not to hinder access

The analysis of performance data shows no evidence that Aurizon Network's announced changed practices have resulted in the availability of train paths in each coal system being insufficient to meet contracted train paths. As noted above, after initial period of volatility, throughputs appear generally unaffected.

Pursuant to the terms of UT4, but also under relevant provisions of the Queensland Competition Authority Act 1997 (QCA Act), Aurizon Network (as an access provider) is prohibited from preventing or hindering access to the declared service. However, the regulatory framework does not expressly require Aurizon Network to manage its maintenance operations in any particular way and, subject to its contractual obligations, it has flexibility as to the scheduling of maintenance works. Aurizon Network's conduct and the way it performs its maintenance services may have changed but it would not appear that access has been prevented or hindered, or that Aurizon Network is not meeting its obligations to access holders under UT4.

As matters stand, the QCA has not found any evidence to establish that Aurizon Network is not meeting its obligations for provision of below-rail services.

Planning and scheduling

Aurizon Network also has provided information in line with its obligations for planning and scheduling train services on the CQCN. For instance, the monthly train plan is available, which sets out assumptions and identifies maintenance activities.

There are a range of other regulatory processes, such as those included in the Network Management Principles and System Rules, outlining how Aurizon Network and users interact in the operating environment, including how train plans and schedules are developed, communicated and amended. The System Operating Parameters (SOPs) set out the assumptions underlying the operation of each element of the supply chain.

Despite the key inputs of track maintenance requirements, Aurizon Network has not amended the System Rules or the SOPs following its changed maintenance practices. Under clause 7A.5(c) of UT4, the QCA can request Aurizon Network to update the SOPs. However, given that throughput does not appear to have been impacted, the QCA has not identified a clear justification for making such a request at this time.

Supply chain coordination

Aurizon Network also said it provides a substantial amount of information in relation to maintenance activities to stakeholders and recognises the importance of timely and accurate communication for stakeholders to manage their own operations.¹¹

However, Aurizon Network's approach in relation to the change in maintenance practices does not appear to have been consultative or collaborative. Stakeholders have observed that existing information has not assisted in readily discerning what the impacts are on their operations.¹² Coal industry members have said Aurizon Network has not engaged with industry in a manner that would assist them to better understand the extent and nature of the

¹⁰ Aurizon Network (June 2018) Response to QCA on UT5 Maintenance, pp. 23, 25.

¹¹ Aurizon Network (June 2018) Response to QCA on UT5 Maintenance, p. 28.

¹² Aurizon Coal (June 2018) Response to QCA on UT5 Maintenance, p. 4.

changes and that it is using maintenance as a weapon to disrupt access and extract a favourable result in relation to UT5 revenue.¹³

While we have not identified evidence that Aurizon Network has breached its formal UT4 requirements, it is apparently the case that the information provided in relation to maintenance activities and network operations has not been sufficient to satisfy stakeholders' needs. Despite the amount of information (both required by UT4 and in the operational environment), this has not assisted stakeholders to deal with this issue and make informed decisions on what was happening. In essence, stakeholders appear to have not been provided with timely, accurate information when they needed it most.

All things considered, Aurizon Network's decision and actions, while seemingly consistent with its UT4 obligations, have resulted in some disruption and uncertainty among supply chain participants.

Reporting

Part 10 of UT4 provides for various detailed reporting indicators, designed to afford additional transparency to stakeholders. The QCA has used the quarterly performance reports to assess whether there have been any impacts on throughput since the maintenance changes. Quarterly maintenance cost reports are also published, showing comparison of actual spend to the QCA's allowance.

Aurizon Network has generally complied with the reporting requirements under UT4. Aurizon Network is undertaking to publish aggregated Train Service Entitlement reports, as required under Schedule G 7.6(b) of UT4.

¹³ QRC (June 2018) Response QCA on UT5 Maintenance, pp. 5, 8.

Attachment 1

CQCN throughput and performance

Observations from network data:

- CQCN throughput—an initial effect observed but not a sustained drop in overall CQCN throughput since Jan '18. Record volumes in FY18, with monthly record volume in June 2018
- Monthly throughput FY18—shows signs of increased volatility since Jan '18
 - Goonyella system performance driving force behind CQCN volatility (see **Fig 2** shown in dark blue)
 - Blackwater throughput increased steadily after an initial drop in throughput between Dec '17 and Feb '18 (see **Fig 2** shown in yellow).
 - steady throughput in all other systems from Jan '18 onwards.

Note: Fig. 1 July '17 data includes impacts of April 2017 floods.

Figure 1: System throughput: Net tonnes by quarter over FY17 and FY18

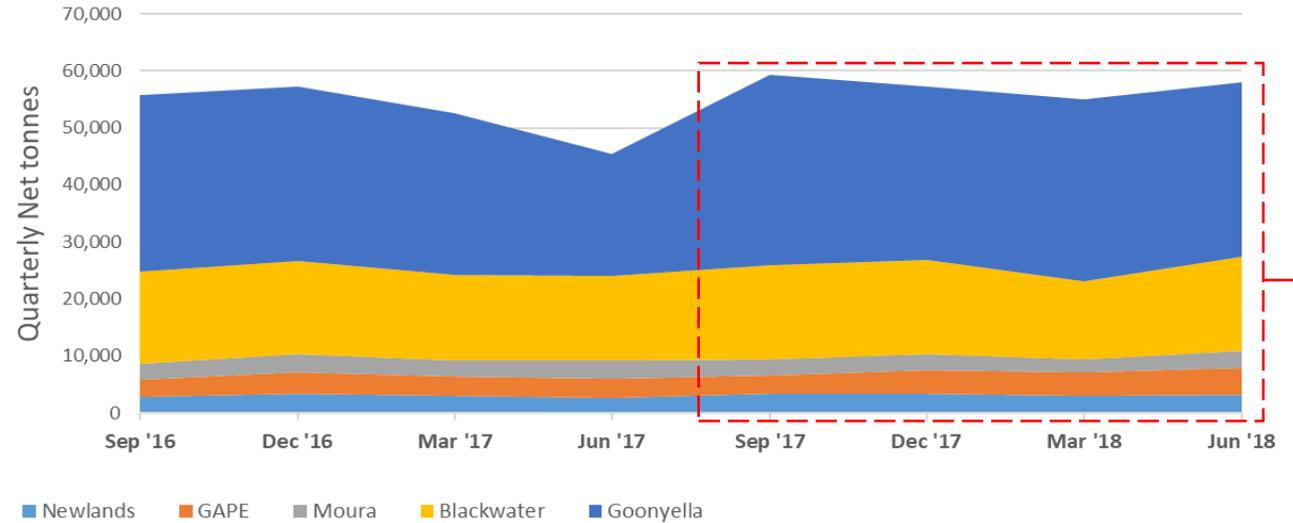
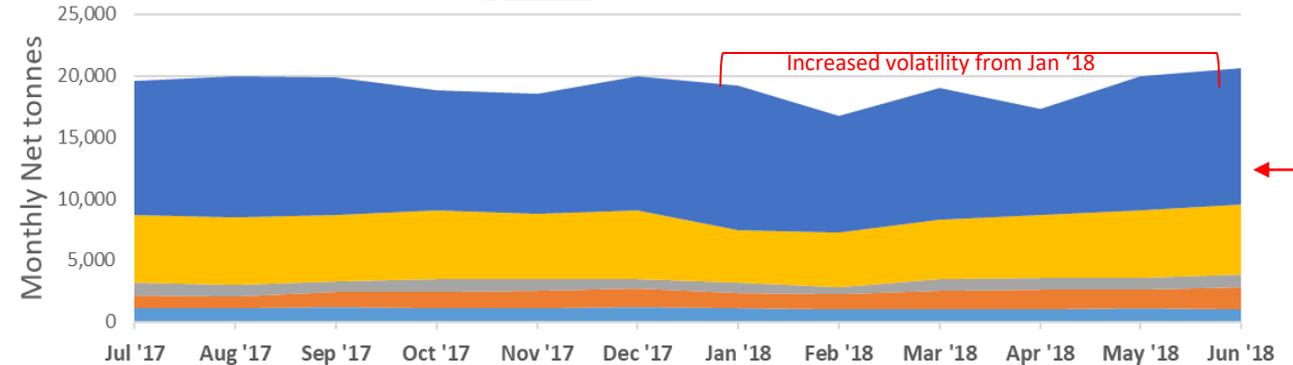


Figure 2: System throughput: Net tonnes by month over FY18



CQCN train path usage

Train path usage data:

- CQCN train path usage—no material or sustained drops in usage of contracted train paths (see **Fig 3**)
- System train path usage FY18—shows signs of volatility from January 2018
 - Goonyella system train path usage driving CQCN results. Increased gap between contracted and used train paths evident in Feb '18 and Apr '18. (see **Fig 4**)
 - Blackwater system showed declining gap between contracted services not used. Above contracted levels of train paths used between Apr '18 and Jun '18 (see **Fig 5**).

Figure 3: CQCN train path usage Jan '17 to Jun '18

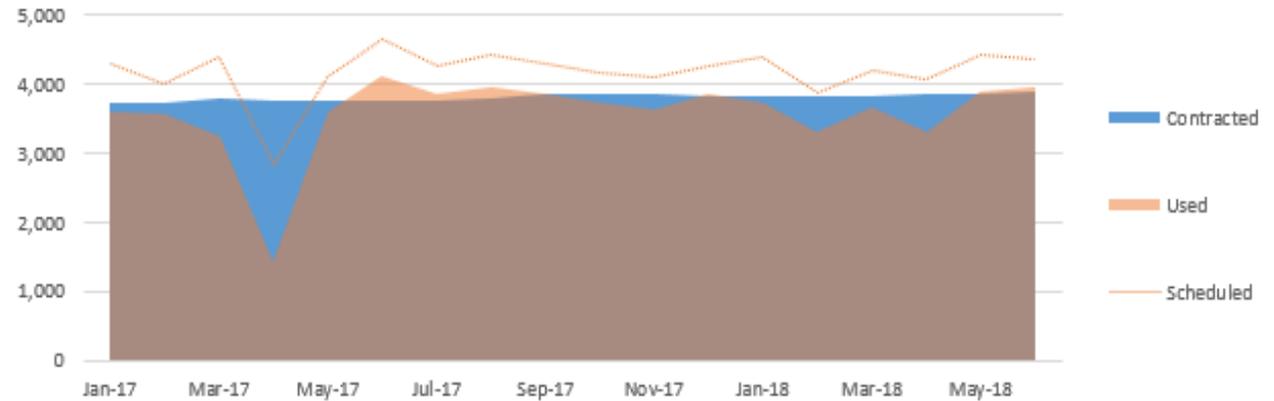


Figure 4: Goonyella train path usage since Jan '18

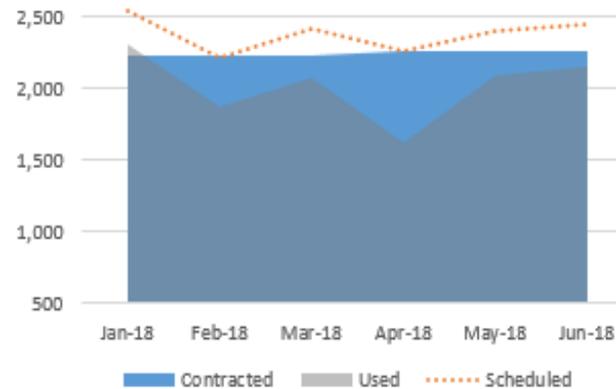
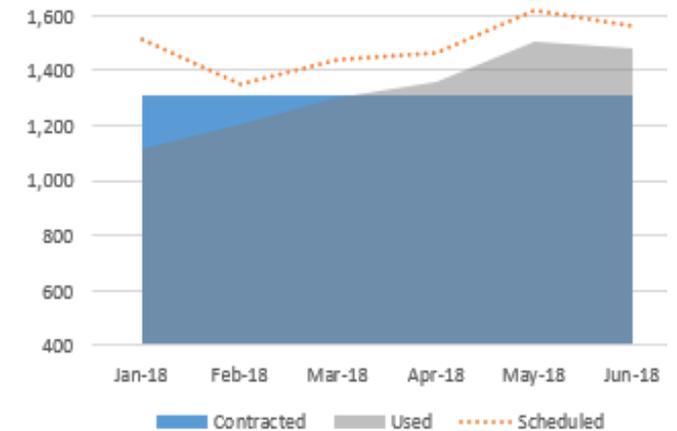


Figure 5: Blackwater train path usage since Jan '18

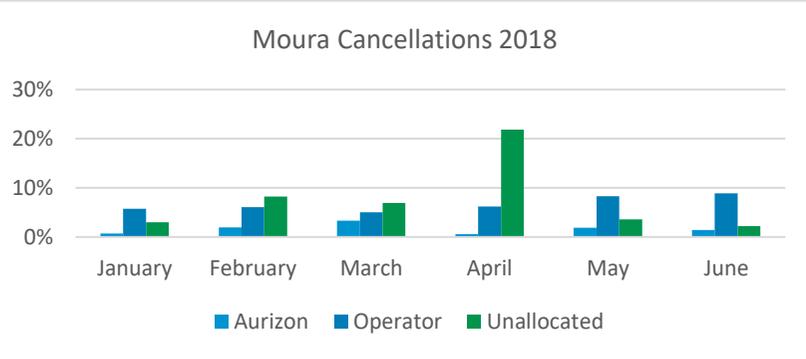
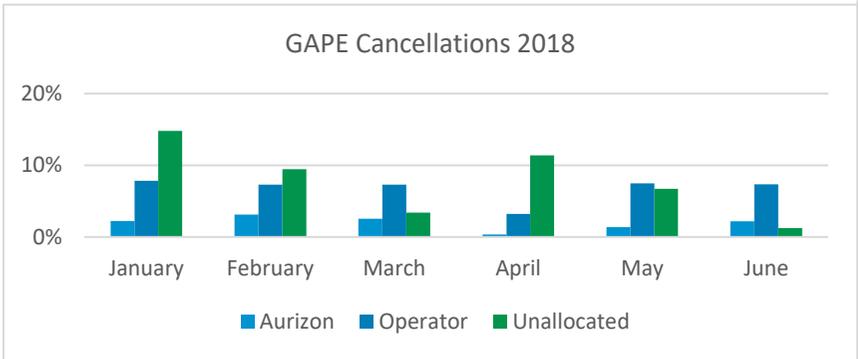
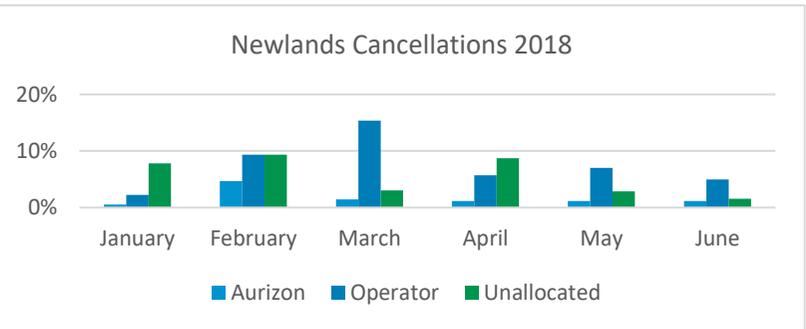
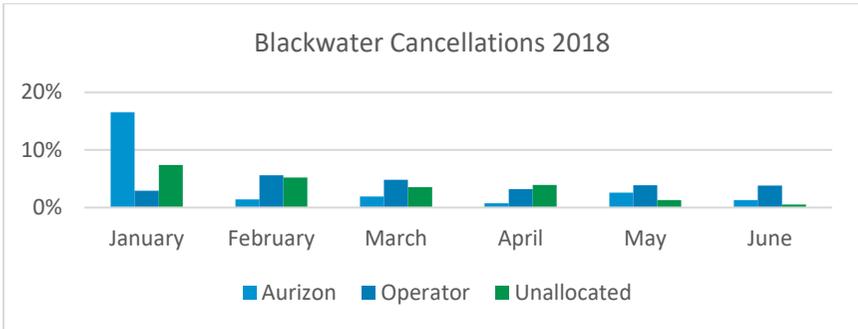
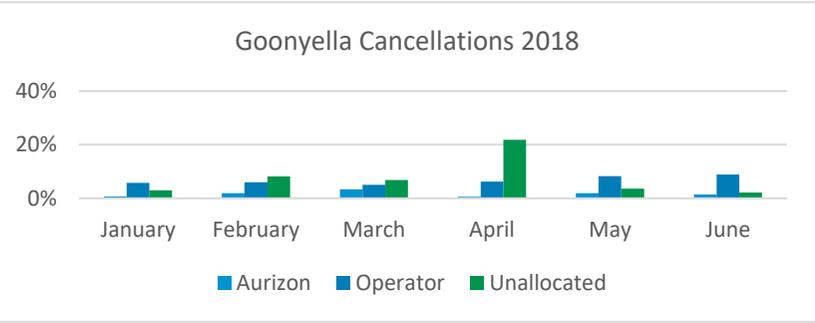


CQCN Network reliability – train cancellations by system and cause

Train cancellations were volatile over the January to April 2018 period, aligning with the volatile throughputs observed over the same period.

Cancellations over May and June 2018 were generally less volatile.

Cancellations due to Aurizon cause remained generally low.



Other indicators

Over the CQCN, fewer train paths allocated to planned maintenance over the May and June 2018 period corresponded with an increase in train paths used.

