

# GLENCORE

## Submission to the Queensland Competition Authority (Confidential version)

### Executive Summary

Glencore supports the submission of the Queensland Resources Council in respect of the Queensland Competition Authority's (QCA) Final Decision regarding Aurizon Network's draft access undertaking (UT4) (except to the extent that the submission endorses the approval of the UT4 Access Undertaking). In addition to that submission, Glencore is also making this submission which considers the appropriate treatment of certain issues regarding the Wiggins Island Rail Project in UT4.

In relation to the treatment of the Wiggins Island Rail Project in UT4, Glencore submits that:

- Aurizon Network has imposed "Access Conditions" in respect of access to the Wiggins Island Rail Project infrastructure in the form of the "WIRP Deed".
- The imposition of the WIRP Deed Access Conditions was approved by the QCA for the purposes of the UT3 Access Undertaking. We do not dispute the appropriateness of this decision for the purposes of the UT3 regulatory period, given the circumstances which prevailed at the time including the lack of any effective user funding mechanism as recognised in the QCA's decision to approve the WIRP Deed Access Conditions.
- The previous decision under the UT3 Access Undertaking does not legally fetter the QCA's ability to decide how to treat this issue in respect of UT4.
- There is no economic justification for excluding the provisions of the WIRP Deed (including the revenue received by Aurizon Network under the WIRP Deed) from the QCA's review of the UT4 Access Undertaking.
- No approval has been given for the imposition of such Access Conditions during the UT4 Access Undertaking period, and no approval ought to be given even if it is sought during the period of the UT4 Access Undertaking.
- The approval of the terms of the WIRP Deed as Access Conditions during the UT4 period would be inconsistent with the objectives of the *Queensland Competition Authority Act 1997 (Qld) (QCA Act)* as it would result in Aurizon Network earning a higher return from the regulated network than the regulatory Approved WACC (which is set as the economically efficient price) without sufficient justification to allow this higher return to be permitted.
- On the basis that the WIRP Deed terms are not approved as Access Conditions for the UT4 Access Undertaking period, 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.
- The tariffs for those Access Holders which are subject to the WIRP Deed should be set such that, when taken together with the fees payable under the WIRP Deed, the total amount payable is equivalent to the tariff which would otherwise be payable in the absence of the WIRP Deed.
- It would not be appropriate, in accordance with section 138 of the QCA Act to approve Aurizon Network's proposed UT4 Access Undertaking without the tariffs for WIRP Users being adjusted on that basis.

### Confidentiality

Glencore understands that the QCA has a copy of the WIRP Deed in connection with its previous consideration of the Access Conditions imposed under the WIRP Deed. It has therefore not provided a

copy of the WIRP Deed with this submission and, and requests that all references to specific provisions of the WIRP Deed are kept confidential and not disclosed in the public version of this submission. In making this submission Glencore does not intend to prejudice the confidentiality of its own or Aurizon Network's affairs.

## 1. Introduction

The Wiggins Island Rail Project ("WIRP") comprises additional rail infrastructure in the Blackwater and Moura systems and on the North Coast line, including infrastructure required to provide the additional below rail capacity necessary as the result of the construction of the Wiggins Island Coal Export Terminal ("WICET").

Under the UT3 Access Undertaking, Aurizon Network was not required to fund the development of WIRP and nor did any workable user funding option exist. It was not possible for the relevant access seekers (the "WIRP Users") to construct the required rail infrastructure themselves. Aurizon Network as a monopoly infrastructure owner was therefore in the position of being able to extract an above regulated rate of return as a pre-condition of its agreement to construct WIRP. In order to proceed with the funding and construction of WIRP, Aurizon Network required the WIRP Users to execute the Wiggins Island Rail Project Deed (2011) (the "WIRP Deed"). Although the WIRP Users conducted extensive negotiations with Aurizon Network, including, in the case of Glencore, discussion of a user funding option, ultimately the WIRP Deed contained the conditions that Aurizon Network insisted on in order to proceed with the funding and construction of WIRP.

The commercial substance of the WIRP Deed is that it imposes a fee ("WIRP Fee") [REDACTED] on the WIRP Users [REDACTED]. It also acts as a [REDACTED] access agreement in respect of the capacity which is contracted by each WIRP User, such that in addition to the WIRP Fee, the WIRP Users pay reference tariffs for access in accordance with the applicable QCA approved access undertaking.

Under both the UT3 Access Undertaking and the proposed UT4 Access Undertaking, the imposition of "Access Conditions" in addition to the payment of regulated Access Charges is permitted subject to an approval process in respect of those conditions. Aurizon Network proposed the WIRP Deed for approval as an Access Condition during the UT3 Access Undertaking period. The WIRP Users ultimately endorsed the WIRP Deed. However, since the funding and construction of WIRP was at the discretion of Aurizon Network, if the WIRP Users had not given this endorsement, it was clear there was little prospect that Aurizon Network would have gone ahead with the funding and construction of WIRP within the period required by the WIRP Users at the time. On the basis of this endorsement, the QCA approved the terms of the WIRP Deed with only a limited merits review, on the assumption that they constituted "Access Conditions" which had been approved by the relevant Access Seekers.

## 2. Relevance of UT3 Approval of Access Conditions

Glencore acknowledges the decision of the QCA to approve the WIRP Deed Access Conditions for the purpose of the UT3 Access Undertaking. We do not dispute the appropriateness of this decision for the purposes of the UT3 Access Undertaking period. In the circumstances of the time, the QCA was faced with the choice of either approving the WIRP Deed Access Conditions for the purposes of the UT3 Access Undertaking or accepting that Aurizon Network would not proceed with the funding and construction of the WIRP within the period that the WIRP Users required. In particular, there was no workable user funding option available to the WIRP Users which would have provided a fall back option to address a refusal by Aurizon Network to fund WIRP. The WIRP Users also supported the approval of the WIRP

Deed Access Conditions under the UT3 Access Undertaking process, given the lack of any workable alternative existing at the time.

However, the UT3 Access Undertaking will shortly expire and it is clear that both:

- (a) a decision made under the UT3 Access Undertaking is not legally binding on the QCA in respect of the appropriate treatment of tariffs in the UT4 Access Undertaking; and
- (b) section 138 of the QCA Act requires the QCA to only approve a new access undertaking (such as UT4) if it considers it appropriate to do so on its own merits.

Glencore has received the enclosed legal advice from its legal advisors (Allens) which confirms the accuracy of this legal position. Given this legal position, in our view the re-examination by the QCA of the appropriate total return which Aurizon Network is able to receive from the regulated network (including the WIRP Fee) is relevant to the QCA's review of the provisions of UT4 Access Undertaking.

It might be argued that as a concluded contract, the WIRP Deed should never again be subject to any regulatory review. We do not accept that this would be an appropriate view for the QCA to take. The WIRP Deed is not independent of the regulatory access arrangements – as we will outline in this submission, the terms of the WIRP Deed are integral to the access arrangements for WIRP, which is an integral part of the regulated network. The WIRP Deed was subject to regulatory review during the UT3 Access Undertaking period and it was recognised by all parties that a QCA approval was necessary in order to allow Aurizon Network to enjoy the benefit of the additional revenue generated by the WIRP Deed during the UT3 Access Undertaking period. The regulatory approval was given for the UT3 Access Undertaking period based on the circumstances which then existed. Different circumstances now apply. Glencore does not believe that simply by entering into a long term contract (such as the WIRP Deed) which extends for a number of regulatory periods, Aurizon Network should be able to exclude regulatory oversight of the matters which are governed by such agreement for all regulatory periods other than during the first regulatory period. Further, Glencore does not believe that the QCA's approval of the WIRP Deed Access Conditions was intended to have the effect of excluding future re-examination of the matter.

Glencore does not accept that setting reference tariffs to apply in the future, taking into account the appropriateness of the WIRP Deed Access Conditions for the purpose of the UT4 Access Undertaking, would have any retrospective effect, any more than the review of the appropriate regulatory WACC to apply in that future period has a retrospective effect. In both cases, it is appropriate for the QCA to consider the continuing economic efficiency of the returns which Aurizon Network is entitled to receive from its operation of the regulated network. In both cases, a decision is being made by the QCA in relation to the appropriate returns available from capital which was invested by Aurizon Network in the past. Glencore does not see any strong economic justification to treat the reconsideration of the provisions of the WIRP Deed in a different manner from any other part of its regulated business.

### **3. Application of section 138(2) factors**

In determining whether it is appropriate to approve an access undertaking, the QCA is required to have regard to the factors set out in section 138(2) QCA Act, namely:

- (a) the object of Part 5 of the QCA Act;
- (b) the legitimate business interests of the owner or operator
- (c) if the owner and operator of the service are different entities – the legitimate business interests of the operator of the service are protected;
- (d) the public interest, including the public interest in having competition in markets (whether or not in Australia);

- (e) the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected;
- (f) the effect of excluding existing assets for pricing purposes;
- (g) the pricing principles mentioned in section 168A of the QCA Act; and
- (h) any other issues the QCA considers relevant.

Glencore considers that it is clear that these factors indicate that it would be inappropriate to approve UT4 without the adjustments to the tariffs applicable to WIRP Users set out in this submission. An analysis of how the relevant factors would apply to the assessment of this issue is provided below.

#### ***Object of Part 5***

The object of Part 5 of the QCA Act is to promote the economically efficient operation of, use of and investment in significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets. Efficient use of existing infrastructure necessarily requires efficient pricing of access that reflects the costs and risks of providing the access.

As recognised in the QCA's Final Decision in respect of UT4 (Volume 1 at 13):

*A return that generates windfall gains or monopoly profits would be inconsistent with economically efficient investment, operation and use of a regulated network and has the potential to have both upstream and downstream investment impacts.*

The WIRP Fee is clearly a return above the revenue that the QCA determined was appropriate in approving reference tariffs. As such, Glencore considers it is clear that the WIRP Deed provides monopoly profits and results in inefficient access pricing that reflects Aurizon Network's market power at the time of negotiating the WIRP Deed. The imposition of the WIRP Fee above and beyond the regulated and economically efficient price for access cannot be consistent with the object of Part 5 of the QCA Act. There are no special factors which would justify the imposition of the WIRP Fee during the UT4 period.

#### ***Legitimate business interests of Aurizon Network***

Glencore acknowledges that (as per the QCA's Final Decision in respect of UT4: Volume 1 at 9), Aurizon Network's legitimate business interest include:

*recovering revenue for the service that is at least enough to meet the efficient costs in providing the relevant service and in earning a return on investment commensurate with the regulatory and commercial risks involved in supplying the declared service.*

While Glencore appreciates that Aurizon Network has a commercial interest in maximising revenue, Aurizon Network does not have a *legitimate* interest in earning monopoly profits that are not commensurate with the regulatory and commercial risks involved. This is exactly what the WIRP Fee does where it applies *in addition to* reference tariffs which the QCA has determined fully and appropriately reflect the relevant costs and risks borne by Aurizon Network.

#### ***Public interest***

In relation to the public interest, Glencore notes the QCA's comments in the Final Decision in respect of UT4 (Volume 1 at 10) that:

*Where consumers of rail services sell their products in international markets or face intense competition in their domestic markets, the ability of such consumers to pass on rail transport costs is likely to be constrained. If the costs of providing the service are not efficient, this could undermine the competitiveness of rail operators accessing Aurizon Network's declared service and*

*consumers of above-rail services provided by those rail operators (particularly coal producers in global coal markets).*

It is clear that the imposition of the WIRP Fee reflects additional (and inefficient costs) which adversely impacts on rail operators and coal producers.

#### ***Pricing principles in section 168A***

The pricing principles in section 168A of the QCA Act include that the price for access should 'generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved'.

As set out in the analysis below, the WIRP Fee is a return that is additional to the revenue that the QCA determined was appropriate in respect of the efficient costs and risks involved in providing access under UT3 (and therefore clearly is above the revenue described in section 168A(a) QCA Act)).

#### ***Other issues the QCA considers relevant***

Glencore notes the QCA's comments in the Final Decision in respect of UT4 (Volume 1 at 12) that the interests of access holders and end users are relevant under section 138(2)(h) of the QCA Act, and that one of the issues of particular relevance to such entities is 'the extent to which a regulated entity earns windfall gains and monopoly profits'. That is clearly the position which applies in respect of the WIRP Fee.

## **4. Application of UT4 Access Conditions provisions**

No application has been made by Aurizon in respect of the approval of the WIRP Deed terms as Access Conditions for the UT4 period, and nothing in the UT4 Access Undertaking appears to us to exclude the requirement for such approval. If such an application is made (or such a provision were to be included in the UT4 Access Undertaking), Glencore submits that it should be denied (or that the inclusion of the term in the UT4 Access Undertaking should be rejected) for the reasons set out in these submissions, based on the criteria set out in section 138 of the QCA Act.

Given that the current decision being made by the QCA relates to the approval or non-approval of the UT4 Access Undertaking (rather than being a decision which is made under the terms of the UT4 Access Undertaking), the terms of the UT4 Access Undertaking (and indeed the UT3 Access Undertaking) need not necessarily be followed by the QCA in making its decision. However, Glencore appreciates that as part of making the Final Decision in respect of UT4, the QCA gave careful consideration to the provisions of the UT4 Access Undertaking and may therefore consider them a relevant issue for the purposes of section 138(2)(h) QCA Act. Accordingly, Glencore has considered how the WIRP Deed terms would be analysed under the proposed UT4 Access Conditions provisions.

### **Access Condition Report - requirements**

In accordance with clause 6.13.1(a), the UT4 Access Undertaking permits the imposition of Access Conditions:

*to the extent that this is reasonably required in order to mitigate Aurizon Network's or the Access Seeker's exposure to any additional costs or risks associated with providing Access for the Access Seeker's proposed Train Service and which are not, or would not, be included in the calculation of the Reference Tariff based on the Approved WACC.*

It is therefore perhaps trite to state that Access Conditions are not permitted to the extent to which they are not reasonably required to mitigate any exposure to additional risks or costs which are beyond those which are already included in the calculation of the Reference Tariff based on the Approved WACC. This statement is nevertheless of fundamental importance. The remaining provisions of clause 6.13.2, including the restrictions on the QCA's ability to examine the merits of the Access Conditions which are proposed in the case where all of the Access Seekers have consented to those conditions, depend upon these Access Conditions actually meeting this fundamental requirement. The QCA is not obliged (or empowered by the UT4 Access Undertaking) to approve any proposed agreement between Aurizon Network and an access seeker under clause 6.13.2 without enquiry as to whether it satisfies the fundamental requirement set out in clause 6.13.1.

The approval process requires the provision by Aurizon Network of an Access Conditions Report which details the following matters:

- (i) the Access Conditions that Aurizon Network is seeking from any Access Seeker;*
- (ii) quantification of the additional costs or risks Aurizon Network is exposed to (the **Additional Risks**), which it is seeking to mitigate through the Access Conditions;*
- (iii) why Aurizon Network's exposure to the Additional Risks would not be:*
  - (A) reasonably mitigated by an Access Agreement which permits Aurizon Network to charge Access Charge(s) calculated in accordance with a Reference Tariff based on the Approved WACC and 100% Take or Pay commitments; or*
  - (B) more efficiently mitigated through insurance or other financial instruments;*
- (iv) to the extent that the Access Conditions being sought indicate Access Charges being calculated based on:*
  - (A) adjustments to cash flows, evidence that there are risks not mitigated by the other Access Conditions being sought, and the adjustments are reflective of the possible outcomes and probabilities of the outcomes as a consequence of such risks; and/or*
  - (B) a Varied WACC, evidence that there is either a materially different risk-free rate or debt margin, or that, as a result of the Aurizon Network funding a capital expenditure project, Aurizon Network would have a materially different gearing ratio or credit rating, from that which was assessed at the time the Approved WACC was determined by the QCA; and*
- (v) confirmation that Aurizon Network considers the proposed Access Conditions would not contravene a provision of this Undertaking or the Act.*

The requirements of the Access Conditions Report have been structured so as to allow the QCA to make an assessment as to whether the fundamental requirements have been met in order for the proposed regime to be able to constitute "Access Conditions" – that is, to provide sufficient information to demonstrate whether the risks and costs which the Access Conditions are designed to address are truly additional to the risks and costs which are assumed in setting the Reference Tariffs and the Approved WACC.

#### **Information contained in the WIRP Access Conditions Report**

The Access Conditions Report provided by Aurizon in relation to the WIRP Deed conditions details various risks which Aurizon Network claimed to be additional costs or risks arising as the result of

WIRP. The Access Conditions Report does not quantify any of those risks. In our submission, the risks identified by the Access Conditions Report are highly unlikely to give rise to any additional cost or risk in the UT4 period, and therefore fail to justify consideration of the terms of the WIRP Deed as Access Conditions during that period. Glencore provides further submissions on the risk identified later in this document, and further consideration is also contained in the Castalia report.

The Access Conditions contained within the WIRP Deed amount to the calculation of Access Charges on the basis of a Varied WACC. [REDACTED]

[REDACTED]

The Access Conditions Report does not detail any of these matters.

[REDACTED]

#### Classification of the fees payable under the WIRP Deed

The Access Conditions Report contains the following statement:

*QRNN's proposed Access Conditions do not involve Access Charges being calculated on the basis of adjustments to cash flows as referred to in clause 6.5.4(a)(vii)(A) of the Undertaking. The risks identified as additional to those risks in the standard terms and conditions of the access agreement are included in the payments in addition to the access charges. QRNN is also not seeking a varied WACC as described in 6.5.4(a)(vii)(B).*

It appears to us that the argument being made by these statements is that the charges payable under the WIRP Deed are not "Access Charges" and hence that the Access Conditions Report need not provide the information which would be required to justify the imposition of "Access Charges".

[REDACTED]

[REDACTED]

[REDACTED]

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

However, notwithstanding the inclusion of this drafting, Glencore's view is that the WIRP Deed is properly characterised as an "Access Agreement" for the purposes of the UT4 Access Undertaking. The UT4 Access Undertaking defines an Access Agreement as "an agreement between Aurizon Network and an Access Holder for the provision of Access". If the WIRP Deed is classified as an "Access Agreement" under the UT4 Access Undertaking, then the charges which are made under that document are "Access Charges."

[REDACTED]

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■ [REDACTED]



[REDACTED]

[REDACTED] it is clear that the commercial substance of the bargain contained in the WIRP Deed is that the WIRP Users agreed to pay an additional charge in order to obtain the access rights related to the WIRP project. As will be discussed below, there was no other real service being provided or risk assumed by Aurizon Network under the WIRP Deed, except for the provision of access rights to in respect of WIRP the timely provision of which was incentivised by the WIRP Fee. The strongest case which might be made for Aurizon Network is that the WIRP Fee is merely a charge which happens to be have some correlation with access rights, rather than being a charge for access. However, the correlation is extremely close. The WIRP Fee is a charge:

- based on the cost of the infrastructure used to provide the access rights;
- [REDACTED]
- which (under the terms of the End User Access Agreement Glencore has entered into) is essentially inseparable from the Access Rights; and
- [REDACTED]

It is hard to find any real difference between the incidence of the WIRP Fee and the incidence of a charge for access rights. Consequently, if the QCA accepts that the WIRP Fee is something other than an Access Charge (as defined in the UT4 Access Undertaking), then this seems to amount to a potential flaw in the QCA's ability to effectively regulate preconditions of access sought to be imposed by Aurizon and, as a result, the declared services provided by Aurizon.

The clearest demonstration of the inextricable link between the WIRP Fee and the access rights is that, in a separate dispute between Aurizon Network and the WIRP Users (including Glencore), Aurizon Network itself has made this link explicit. Aurizon Network has stated as part of its statement of claim and response to Glencore's counterclaim in those separate proceedings that:

*the substantial commercial purpose of the WIRP Deed was to give effect to a bargain by which, at the Customer's request, Aurizon undertook significant and expensive infrastructure improvements – which exposed Aurizon to a number of financial risks – in return for payment by each of the Customers of a fee which exceeded what was available under the standard access regime*

*the effect of the Glencore notice (if valid) was... to deprive Aurizon of substantially all of the benefit for which it had bargained with Glencore, namely the right to require Glencore to pay its proportionate share of the amounts payable under the WIRP Deeds, according to its proportionate share of access rights under its Access Holder Access Agreement for Segments 1, 2, 4, and 5...*

*a substantial benefit which Aurizon obtained under the WIRP Deed with Glencore was Aurizon's right to receive from Glencore a WIRP Fee for each Segment to which it had Access Rights*

## **Alleged additional risks and costs identified in the WIRP Access Conditions Report**

The UT4 Access Undertaking provides that Access Conditions may be agreed “to the extent that this is reasonably required in order to mitigate Aurizon Network’s or the Access Seeker’s exposure to any additional costs or risks associated with providing Access for the Access Seeker’s proposed Train Service and which are not, or would not, be included in the calculation of the Reference Tariff based on the Approved WACC.” The reason for this requirement is clear – if Access Conditions are permitted in respect of risks which are already compensated for as part of the permitted revenue cap, then the effect would be to permit Aurizon Network to derive an above regulated rate of return from its regulated activities (in other words derive a monopoly profit through inefficient monopoly pricing). In Glencore’s view, none of the risks identified in Aurizon’s Access Conditions Report provide sufficient justification for the imposition of any Access Conditions in respect of the WIRP Deed during the UT4 period, because they are either without sufficient substance or are identical to the risk and cost used to calculate the Reference Tariff and Approved WACC.

### ***Construction risk***

[REDACTED]

The risk of not being paid the WIRP Fee cannot be an additional risk of providing access that justifies the payment of the WIRP Fee.

Aurizon Network also states that the WIRP Deed has restricted the procurement strategy available to Aurizon Network. It is hard to understand how this statement can be substantiated from the terms of the WIRP Deed, in particular based on the interpretation that Aurizon Network has subsequently placed on the terms of the WIRP Deed.

[REDACTED]

[REDACTED]

[REDACTED]

In these circumstances, it is hard to see how there can be any justification for a conclusion that WIRP involves risks or costs which are not already compensated for as part of the regulated revenue arrangements.

### ***Credit risk***

It appears that the credit risk which is referred to in the Access Conditions Report is the credit risk relating to payment of the fees under the WIRP Deed. While the credit risk in respect of payment of a fee

may be relevant to the calculation of the amount of the fee which should be approved, the risk of not being paid a fee obviously cannot constitute a risk or cost which justifies the imposition of the fee itself.

### *Optimisation risk*

Aurizon Network's justification for claiming that WIRP involved additional optimisation risk was the involvement of the WIRP Users in the process. As is set out above in relation to the construction risk argument, the involvement of the WIRP Users in the project is very limited, with design, procurement and construction remaining completely within the control of Aurizon Network, and therefore we do not believe that WIRP has any additional optimisation risk compared with any other project.

### *Optimisation risk: asset stranding*

WIRP forms part of an integrated track network (see page 18 of the enclosed report from Castalia for a clear demonstration of this). All of the assets constituting WIRP (with the exception of the balloon loop at the WICET unloading facility) are used by both WIRP Users and non-WIRP users. If access seekers which are not parties to a WIRP Deed wish to access WICET through the balloon loop, then this infrastructure will also be used by both WIRP Users and normal regulated traffic. The cost of WIRP will be included in the regulatory asset base and will be allowed to be recovered through regulated access charges. Given that the infrastructure forms part of the regulated network and is used by regulated traffic, and the cost of WIRP is allowed to be recovered through access charges in exactly the same way as any other part of the regulated network, we cannot see that WIRP faces a degree of stranding risk which is different from the regulated network.

### *Financing risk*

Glencore is not aware that Aurizon Network adopted a separate method of funding WIRP which was significantly more costly than the funding methods used for the needs of other parts of its regulated network. If such a separate approach had been used, then the Access Undertaking could recognise this impact on Aurizon Network's funding as the justification for a Varied WACC. However, no such variation was sought. If it had been sought, then the Access Undertaking would have required additional justification.

The Access Condition Report argues that it should not be assumed that retained earnings are available for investment at the regulatory WACC. If it were to be accepted that the "opportunity cost" of investing at the regulated WACC when compared with possible unregulated rates of return is a cost which is allowed to be compensated for by payment of an Access Condition, then this would mean that Aurizon could always demand Access Conditions sufficient to provide it with an unregulated rate of return on any investment it makes. This is not consistent with the reference tariffs being set by the QCA at a level that is appropriate to reflect the risk profile for Aurizon Network in the absence of any access conditions.

Even if it might be argued that Aurizon Network faced an additional risk in respect of the availability of finance during the construction of WIRP, that construction is now complete and WIRP forms an integrated part of the regulated network. There is no possible argument for any continued differential funding risk on this basis.

### *Performance risk*

As mentioned above, the WIRP Fee is adjusted downwards if access to WIRP is not made available. Aurizon Network argues that this risk of not being paid the WIRP Fee is an incremental risk to those risks which are taken account of in determining the Approved WACC. While the risk of not being paid the WIRP Fee might be argued to be relevant to the appropriate size of the WIRP Fee, Glencore believes that it is obvious that the risk of not being paid the WIRP Fee is not an additional risk or cost which would

justify the WIRP Fee itself. If the suggestion was intended to be that the risk of aggregate underperformance (i.e. failing to deliver contracted train paths) is a risk that is created, it is difficult to see why that reason is not already part of the existing profile assumed by the QCA in setting the appropriate reference tariffs.

#### *Site remediation costs*

WIRP forms an integrated part of the regulated network. The WIRP infrastructure does not differ in likely site remediation cost from any other part of the regulated network. There is no additional risk or cost in relation to site remediation costs that could justify the approval of the terms of the WIRP Deed as an Access Condition.

### **5. Interaction with appropriate reference tariffs**

Based on the analysis above, Glencore submits that the WIRP Deed terms (and particularly the WIRP Fee) should not be approved as Access Conditions for the purposes of the UT4 Access Undertaking.

On the assumption that the terms of the WIRP Deed are not approved as Access Conditions for the purposes of the UT4 Access Undertaking, this gives rise to the question of how this should be reflected in the relevant System Allowable Revenues and the tariffs which are applicable during the UT4 period (in order for UT4 to be determined to be appropriate by the QCA in accordance with section 138 of the QCA Act).

Because the WIRP Deed is a binding legal document, a decision of the QCA cannot directly release the WIRP Users from their obligations under the WIRP Deeds. The WIRP Fees will therefore remain payable to Aurizon Network to the extent provided for in the WIRP Deed.

However, because the WIRP Fees have been found to be providing Aurizon Network with a return in excess of what is permitted by the regulatory regime, Glencore submits that these sums should be included as "Access Charges" when determining whether Aurizon has earned in excess of the System Allowable Revenue in the relevant systems. In fact, given the submissions set out above (specifically, that the WIRP Deed constitutes an "Access Agreement" as defined by the Access Undertaking), Glencore believes that this must necessarily follow.

This approach is consistent with the QCA's view (UT4 Final Decision, Volume 3 at 95) that:

*We do not consider that negotiations for access conditions should occur unconstrained. We maintain that regulatory oversight plays a pivotal role in preventing Aurizon Network from leveraging its unique position to extract monopoly rents*

However, Glencore believes it would be inequitable and inappropriate to simply include the revenue within the System Allowable Revenue test with the result of potentially crediting back all users within the relevant coal system with the above regulated charges which Aurizon Network has over-recovered as a result of the payment of fees by the WIRP Users under the WIRP Deed. The socialisation caused by such a result would involve the WIRP Users cross-subsidising the non-WIRP Users in the relevant coal system (which is not an appropriate outcome given the distortion that may cause in investment decisions in other markets).

In order to avoid this situation, the QCA should require the setting of a differential tariff for Access Holders which are a party to the WIRP Deed such that the *net* amount payable (inclusive of the fees payable under the WIRP Deed) is equal to the Reference Tariff which would otherwise have applied (inclusive of any System Premium). This can place the WIRP Users (and Aurizon Network) in the same

position as if the WIRP Deed had not been entered into in respect of the UT4 Access Undertaking period, thereby returning Aurizon Network's access pricing for WIRP Users to efficient levels reflective of the actual cost and risk borne.

The appropriateness of this approach is aptly described in the enclosed report from Castalia as follows:

*In the absence of the on-going matching of the totality of risks and rewards under the Access Undertaking and the Access Conditions, there is a high probability of inefficient extraction of monopoly rents.*

*While QCA cannot repudiate its approval of the WIRP Deed, it needs to ensure that the totality of the balance of costs and risk—that is Access Undertakings plus the WIRP Deed— remains appropriate.*

*To achieve the objectives set for it in the legislation, QCA has the ability to adjust the WACC in Access Undertakings to take account of the effect of WIRP Fee on the overall risks and rewards that Aurizon gets from the Access Undertaking and WIRP Fee combined. Our analysis shows that such an adjustment is necessary.*

If you have any queries in relation to this submission please do not hesitate to contact Frank Coldwell, Glencore Coal Assets, Australia.

28 July 2016