

File Ref: 1444430

26 May 2021

Ms Pam Bains
Group Executive Network
Aurizon Network Pty Ltd
GPO Box 456
Brisbane Qld 4001

Dear Ms Bains

Approval—draft Newlands FY22 maintenance strategy and budget

The Queensland Competition Authority (QCA) approved Aurizon Network's draft Newlands FY22 maintenance strategy and budget (MSB) on 26 May 2021. The attached decision notice sets out the basis for this decision.

This letter and decision notice will be published on the QCA website for stakeholders' information. We intend to publish redacted versions of stakeholder submissions along with a redacted version of Aurizon Network's response on our website on 31 May 2021. This decision has been made having regard to section 239 of the QCA Act. QCA staff will be in contact with Aurizon Network staff to confirm these redactions prior to publication.

This process has highlighted that some users believe that Aurizon Network has acted inappropriately in relation to its rail grinding activities—allegedly behaving in a manner that is inconsistent with good corporate governance and having limited consultation with, or consideration of, its customers' interests—and that this has adversely affected users and sets a troubling precedent for future activities.

It is concerning that some stakeholders hold these views, given that the successful operation of the strategy and budget processes, and other arrangements under the 2017 access undertaking (UT5) more broadly, rely on ongoing collaboration between Aurizon Network and its customers with a view to achieving solutions that will deliver mutual benefits for all stakeholders. However, we consider that these matters go beyond determining a prudent and efficient FY22 maintenance allowance under cl. 7A.11.3(p)(i) of UT5.

On that basis, we encourage Aurizon Network to strengthen its efforts to pursue opportunities to enhance collaboration with the RIG and customers, so as to improve the quality of information provided, the nature of engagement and levels of trust where these are lacking or where gaps remain.

I am happy to discuss any questions you may have on this or any other matters. Should your staff have any specific queries on the attached paper, please direct them in the first instance to Zoe Wyatt on 07 3222 0547, or by email zoe.wyatt@qca.org.au.

Yours sincerely



Charles Millstead
Chief Executive Officer

cc: *Jon Windle, Network Regulation Manager, Aurizon Network*

DECISION NOTICE

AURIZON NETWORK'S DRAFT NEWLANDS FY22 MAINTENANCE STRATEGY AND BUDGET— DECISION

26 MAY 2021

The Queensland Competition Authority (QCA) has approved Aurizon Network's draft Newlands FY22 maintenance strategy and budget (MSB). The reasons for this decision are set out in this notice, in accordance with Aurizon Network's 2017 access undertaking (UT5).

Background

Aurizon Network's 2017 access undertaking (UT5) requires Aurizon Network to engage with stakeholders to develop its maintenance and renewals strategies and budgets through the Rail Industry Group (RIG), with the view to developing approved strategies and budgets for each system for the following year (cl. 7A.11.3).

In January 2021, Aurizon Network provided the chair of the RIG with its final draft maintenance strategy and budget¹ to be put to a vote of the relevant end users for each coal system—where end users either approve the draft as proposed by Aurizon Network, approve an alternative, or elect to not approve any strategies or budgets (cl. 7A.11.3 (j)).

In February 2021, the chair of the RIG advised that the required majority of end users² did not approve the maintenance strategy and budget (MSB) for the Newlands system.

In March 2021, Aurizon Network sought our approval of the final draft MSB for the Newlands system and GAPE (as required by cl. 7A.11.3(k)(iii)).³ The proposed MSB reflects the final draft proposal (that had been voted on, and not accepted by Newlands users) which provides for a direct maintenance cost allowance (excluding ballast undercutting plant depreciation) of \$12.3 million for the Newlands system and GAPE. Aurizon Network has estimated that \$3.8 million of the proposed budget would be recovered from the Newlands system.⁴

¹ Aurizon Network, *FY22 Final Draft Maintenance and Renewals Strategy and Budget Central Queensland Coal Network*, January 2021, pp. 191–192 (Aurizon Network MRSB). An extract was provided as Appendix E to Aurizon Network's submission.

² The voting threshold requires a special majority of end users in each system—defined as the number of voting end users that in aggregate hold at least 75 per cent of the end user voting rights held for the year (based on access rights), and at least 60 per cent of voting end users by number at the relevant time.

³ Aurizon Network, *Maintenance Strategy and Budget 2021–22*, letter and submission, March 2021 (Aurizon Network submission).

⁴ Aurizon Network MRSB pp. 160, 192.

Where Aurizon Network submits a draft MSB for approval, we are required to determine whether the activities and costs specified are prudent and efficient—and must approve the draft MSB as submitted or an alternative (cl. 7A.11.3(p)). UT5 does not specify particular requirements or provide guidance on the nature of our assessment or the approach we undertake.

Aurizon Network's proposal

Aurizon Network's draft Newlands FY22 MSB applies across the Newlands system and GAPE. Aurizon Network said it seeks to promote the safety, reliability and performance of Newlands system and GAPE rail infrastructure and ensure that committed capacity is delivered⁵

The proposed maintenance allowance (Table 1) of \$12.3 million (excluding ballast undercutting plant depreciation) is \$0.4 million more than the current FY21 full year maintenance forecast. Aurizon Network said this reflected the net impact of cost escalation and scope changes (\$0.7 million), partially offset by estimated target efficiencies (\$0.4 million).⁶

Table 1 Proposed maintenance allowance and activities—Newlands and GAPE

<i>Proposed budget</i>		<i>Description of activities</i>
<i>Category</i>	<i>FY22 budget (\$m)</i>	
Resurfacing	1.7	Restores geometry of the track and turnouts by lifting and lining to the appropriate level and alignment and compacting the ballast underneath the sleeper.
Rail grinding	1.6	Grinding rail in track and turnouts to remove micro-cracks and small surface faults from the rail, restoring a profile that spreads the contact band, and positions it for better wheel set tracking around the curves.
General track maintenance	3.9	Encompasses the planned corrective maintenance effort, responding to faults identified by drivers, track inspection, specific asset inspection, and track recording and rail flaw detection inspections. Activity can be planned according to the severity and the time period for fault/fault remedy of the identified fault.
Signalling and telecoms	2.7	Inspection and maintenance that is regularly performed on the signalling asset to lessen the likelihood of it failing. Performed whilst the asset is in place and working, so that it does not break down unexpectedly.
Structures and facilities	1.0	Periodic inspection of bridge and culvert structures to monitor asset condition and performance.
Trackside systems	0.2	Inspection and maintenance that is regularly performed on the wayside equipment assets to lessen the likelihood of it failing. Performed whilst the asset is in place and working, so that it does not break down unexpectedly.
Other civil maintenance	0.2	Minor activities on track and turnouts. Includes minor ballast undercutting, a corrective maintenance activity to replace the fouled ballast and mud holes from beneath the sleepers for a length of track up to approximately equal or less than 40 sleeper bays.
Other general maintenance	1.0	Asset management and inventory management.

⁵ Aurizon Network MRSB, p. 159.

⁶ Aurizon Network MRSB, pp. 160–161.

Proposed budget		Description of activities
Ballast undercutting plant depreciation	0.3	Ballast undercutting plant depreciation has been allocated to systems on the basis of the number of days that the RM902 is planned for operation in each system.
Total	12.6	

Source: Aurizon Network, *Maintenance Strategy and Budget 2021–22, Appendix E Newlands Redacted, March 2021, pp. 160, 163–164, 228, 236–237.*

Aurizon Network noted that the key issue that resulted in the Newlands MSB not being approved by end users was the increase in rail grinding costs.⁷

Aurizon Network said the increase in rail grinding costs (\$0.4m from the current FY21 forecast) primarily reflected an increase in mainline scope, given increased volumes as well as an uplift in the mainline grinding rate per kilometre.⁸ Nevertheless, it considered that the proposed rail grinding costs, in total, are in line with the FY21 allowance approved in the UT5 final decision (\$1.6m) and remain consistent with the FY19 actual grinding costs as anticipated in the customer-approved FY21 MSB.⁹

Stakeholder consultation

The draft Newlands FY22 MSB was prepared following engagement with the RIG and customers. This included the chair of the RIG providing detailed feedback on, and proposing amendments to, an earlier draft, and Aurizon Network addressing the individual comments and queries raised.¹⁰

We provided stakeholders with an opportunity to comment on the draft Newlands FY22 MSB and received two submissions, from the chair of the RIG and Glencore.

Both submissions raised concerns regarding increased rail grinding costs—including Aurizon Network's decision to enter into a contract for rail grinding services with an external service provider that featured material rate increases.¹¹ The chair of the RIG suggested that these concerns are shared by users in other systems.

We provided Aurizon Network with an opportunity to respond to the submissions. In its response, Aurizon Network strongly disagreed with the claims and assertions made in stakeholder submissions. Aurizon Network said that the proposed rail grinding costs are prudent and efficient. It said the rail grinding agreement was executed in line with its procurement commitments and delegations of authority. In doing so it assessed comparable competitively tendered market benchmark prices and considered insourcing.¹²

UT5 criteria and QCA assessment approach

UT5 requires the QCA to determine whether the proposed Newlands maintenance activities and costs are prudent and efficient (cl. 7A.11.3 (p)(i)). Therefore, our assessment did not seek to address matters raised by stakeholders that go beyond the question of the prudence and efficiency of maintenance activities and costs.

⁷ Aurizon Network submission, p. 2.

⁸ Aurizon Network MRSB, p. 161.

⁹ Aurizon Network submission, p. 2.

¹⁰ Aurizon Network MRSB, p. 16.

¹¹ Chair of the Rail Industry Group, submission to the QCA, *Newlands FY22 maintenance strategy and budget*, 26 March 2021; Glencore, submission to the QCA, *Newlands FY22 maintenance strategy and budget*, 26 March 2021.

¹² Aurizon Network, response to stakeholder submissions, *Newlands FY22 maintenance strategy and budget*, 23 April 2021 (Aurizon Network response).

We consider this approach to be consistent with our view that we do not prescribe how Aurizon Network should carry out its maintenance work, nor specify how the allowance must be spent.¹³ It also aligns with the broader UT5 principle that provides for Aurizon Network to recover its efficient costs of maintaining the network.

In focusing on prudence and efficiency of maintenance activities and costs, we note that stakeholders have not identified issues or raised concerns about maintenance activities other than rail grinding—and for rail grinding they focused on the proposed costs. Accordingly, our assessment has been directed at those costs.

In doing so, we compared Aurizon Network's proposed FY22 Newlands rail grinding costs with appropriately escalated UT5 approved costs (at a total cost and unit rate level) and FY21 unit rates. We also considered analysis undertaken by Aurizon Network before it entered into the relevant contract, including its analysis of insourcing rail grinding activities and market-equivalent grinding cost benchmarks. We consider this assessment approach is appropriate and proportionate to the size of the claim and the possible impact on customers, having regard to other ongoing processes, including our parallel annual review of Aurizon Network's reference tariffs.

The nature of this assessment means that we are required to protect confidential information that is related to the claim and used in our assessment.¹⁴ We note that Aurizon Network has claimed confidentiality over much of the information it provided in support of its claim¹⁵, both stakeholder submissions and its response to those submissions. While we have considered all relevant information as part of our assessment, owing to confidentiality considerations, we have not presented certain details as part of this decision and have not as yet released the information over which Aurizon Network has claimed confidentiality (but intend to do so, pending finalisation of redactions with Aurizon Network). While not ideal, in this instance we have deemed this necessary and in the interests of making a timely decision.

QCA assessment and decision

We have approved the draft FY22 Newlands MSB as submitted by Aurizon Network (cl. 7A.11.3 (p)(i)).

As noted above, we have focused our assessment on the prudence and efficiency of rail grinding costs, consistent with the issues and concerns stakeholders raised. In doing so, we have accepted that all other activities and costs within the draft Newlands FY22 MSB are prudent and efficient.

After assessing documentation provided and having regard to stakeholder submissions, we consider Aurizon Network's proposed rail grinding costs for the Newlands system are prudent and efficient.

We note that the proposed total cost of Newlands rail grinding remains in-line with approved Newlands UT5 FY21 rail grinding costs. We acknowledge that the mainline grinding rates have increased following the move to the outsourced arrangements and are now higher than those that would be implied by the rates assessed as prudent and efficient in the UT5 assessment. However, we consider the higher rates fall within reasonable bounds and can be adequately explained by:

- rail grinding services now being provided under a contract reflecting market-based rates
- a higher quality and flexibility of service compared to what was provided in UT5.

We note that the proposed FY22 unit rate for turnout grinding has decreased in real terms.

We do not accept stakeholders' view that insourcing rail grinding is necessarily, or always, the most efficient procurement methodology. Rather the most efficient procurement would reflect the relevant circumstances,

¹³ QCA, *Aurizon Network's 2019 Draft Amending Access Undertaking*, position paper, September 2019, p. 7.

¹⁴ In accordance with the provisions of s. 239 of the QCA 1997.

¹⁵ Some of this information has also been provided to the chair of the RIG through the process of developing the draft maintenance and renewals strategies and budgets.

determined on a case-by-case basis. We note that Aurizon Network has outsourced its rail grinding activities consistent with what it considers to be broader industry practice—and executed its grinding agreement in-line with its delegations of authority policy and procurement. This included giving consideration to insourcing prior to entering into the contract.

Way forward

UT5 provides that, on approval, the draft FY22 Newlands MSB¹⁶ will be the approved maintenance strategy and budget for the Newlands system and GAPE (cl.7A.11.3(l)).

Aurizon Network will implement this approved maintenance strategy and budget for FY22. The QCA will subsequently assess whether actual costs are consistent with the approved strategy and budget (cl. 7A.11.5). This approved FY22 Newlands maintenance strategy and budget will also be used in our FY22 annual reference tariff review process (cl.7A.11.4).

¹⁶ As set out in in the *FY22 Final Draft Maintenance and Renewals Strategy and Budget Central Queensland Coal Network* (January 2021).