03 October 2014

Mr Malcolm Roberts
Chairman
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane Qld 4000

By email: rail@qca.org.au

Dear Malcolm,

**Aurizon Network's 2014 Draft Access Undertaking (UT4)**

Vale Australia Pty Ltd (**Vale**) welcomes the opportunity to provide a submission to the Queensland Competition Authority (**QCA**) in respect of the 2014 Draft Access Undertaking (**UT4**) submitted by Aurizon Network Pty Ltd (**Aurizon**). The UT4 submission replaces the 2013 Draft Access Undertaking that was withdrawn by Aurizon Network in August 2014. The 2014 version of the draft access undertaking has been amended to some degree to reflect the views of stakeholders that have been expressed since the submission of the 2013 Draft Access Undertaking, but Vale believes further amendments to UT4 are important for the efficiency of the Central Queensland Coal Network.

Vale has been an active participant in the Queensland Resources Council's (**QRC**) efforts to develop an agreed industry position regarding this matter. We note the QRC will be submitting an industry submission, from these discussions, and Vale takes this opportunity to support the QRC's submission to the QCA. Vale also supports the continued negotiation process between the QRC and Aurizon Network to reach agreement on certain sections of the undertaking. This process is providing opportunities for both parties to understand their respective positions and some substantive progress has been achieved on certain parts of the undertaking through this process.

In the submission guidelines, the QCA has also requested stakeholder comments on the pricing principle to be used for the Wiggins Island Rail Project (WIRP) and simplification of the standard access agreement. Vale provides the below comments on each of these issues.

**WIRP pricing principles**

Aurizon is constructing the Wiggins Island Rail Project to provide rail capacity for stage 1 of the Wiggins Island Coal Terminal. The WIRP infrastructure has been developed by Aurizon under an agreement that allowed them to seek additional access conditions to compensate for perceived additional risks that Aurizon did not believe were covered under the regulated environment.

Vale Australia Pty Ltd ABN 17 062 536 270
Level 11, 100 Creek Street, Brisbane Queensland 4000
GPO Box 731, Brisbane Qld Australia 4001
Tel +61 7 3136 0500 Fax +61 7 3136 0510

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The Wiggins Island Rail Project Proposed Revenue and Pricing Treatment paper has been released by Aurizon in August 2014. In this paper Aurizon outlines its proposed pricing approach for the WIRP infrastructure and concludes that the WIRP infrastructure should be socialised within the existing Blackwater and Moura systems. Vale outlines below its comments on this paper for consideration by the QCA.

Vale is generally concerned with the perceived inconsistency in approach that Aurizon has taken to the development of the WIRP infrastructure, and the final pricing approach that it now wishes to adopt. Aurizon developed the project and the associated agreements confidentially with each of the prospective WIRP users and asked for and was granted additional access conditions to compensate them for their perceived risks of the WIRP project. The submission by Aurizon to the QCA on the WIRP process outlined the following risks that justified a claim for additional access conditions.

- Construction Risk – Specific targets and budgets were set with the customer group
- Credit risk – There was a large number of smaller customers and Aurizon cannot socialise any default among other users
- Optimisation Risk – QCA not accepting the assets into the Regulatory Asset Base
- Asset Stranding Risk – not being able to recover the project due to reduced demand that triggers an optimisation event
- Financing Risk – Aurizon is unable to finance the project or finance under unfavourable conditions.
- Performance Risk – the WIRP Fee is not payable if Aurizon is unable to provide access at the contracted levels and Aurizon cannot recoup this loss via the revenue cap

Aurizon Network has now concluded that the pricing of the project should now be socialised across the Blackwater and Moura users. Vale believes Aurizon Network's justification for socialisation of the WIRP proposed revenue and pricing treatment appears to be inconsistent with the arguments that it presented to justify its claim for additional access conditions.

Socialisation of the pricing for the WIRP infrastructure would remove the credit risk of the large number of smaller customers that was claimed by Aurizon in the development of the WIRP infrastructure. Vale believes that a pricing decision that results in socialisation of the cost of the WIRP infrastructure would reduce Aurizon's credit risk that matches its existing risk under the regulated environment, and therefore, would not present an additional risk not compensated under the regulated WACC.

Socialisation is also likely to reduce the optimisation risk and asset stranding risk to a level consistent with the regulated environment. Aurizon state that a significant proportion of the capital expenditure for WIRP relates to mainline upgrades that will be utilised by both new and existing customers and Aurizon considers it is reasonable to allocate a portion of the capital costs associated with the Blackwater Duplications to the existing Blackwater customers. Based on this statement, Vale believes that there has always been a need for this infrastructure on Blackwater and therefore the risk of optimisation or asset stranding has not changed with the development of the WIRP infrastructure and does not require any further compensation above the regulated WACC.

Aurizon has claimed that 1/7$^{th}$ of the total cost of the duplications should be charged to Blackwater customers to reflect the usage by existing customers. This appears to indicate that the level of capacity developed was always beyond the needs of the WIRP customers, and therefore, the level of Aurizon risk claim for performance during the development of the WIRP infrastructure, and potentially some financing risk, was very low or contributed to by Aurizon's business decisions.

At best, Vale believes the WIRP infrastructure would be subject to construction risk and potentially some financing risk. However, Vale believes the construction risk identified by Aurizon resulted from their business decision to seek additional access conditions to develop the WIRP infrastructure. Due to the additional access conditions being sought, customers wanted to make sure they were provided with the appropriate infrastructure at the right cost and time.

Generally, Vale believes that a pricing decision to socialise the WIRP infrastructure would be inconsistent with the previous WIRP decision that has allowed Aurizon additional access conditions for risks that are reduced by a socialised pricing approach.

Vale would also like to provide comments on other specific issues that have been raised in the Aurizon paper.

Aurizon state that it is reasonable to allocate a portion of the capital costs associated with the Blackwater Duplications to the existing Blackwater customers as these customers endorsed these duplications as part of the 2008 CRIMP process. Vale does not believe that Aurizon can use the 2008 CRIMP process as justification for pricing of this project once it decided to negotiate with individual customers and request additional access condition. The CRIMP pre approval voting process was established to reduce the risk to Aurizon to complete expansions under the regulated process. Vale does not believe this should be applied once Aurizon has made a business decision to expand the network under an alternative method. Vale's is also concerned with the CRIMP voting process as there is no time limit on when Aurizon is required to commence a project that is endorsed by the voting process. Vale understands the quote attributed to the GCEE on page 2 of the paper was in the context of the 2 years that had elapsed since the vote and Aurizon did not appear to be progressing the Blackwater duplications. Vale believes the GCEE statement was also made under an environment where expansions were completed under a regulated environment that did not include additional access conditions.

Aurizon has indicated that it is willing to defer the individual segments of the WIRP capital expenditure commissioned in FY2014 for pricing purposes until FY2015 to align with the WIRP tonnage profile. Vale believes that it would be inconsistent to allow individual segments to be assessed for pricing, or other MAR consideration, when the project was developed as a Significant Investment, by grouping the individual segments to exceed $300 million. Therefore, any impact on Aurizon's pricing or MAR should not be considered until the earliest of the total group of segments are completed or the tonnages related to this Significant Investment has commenced.

Aurizon has chosen to set WIRP volume forecasts for pricing purposes at 90% of contract. This does not appear to be consistent with the recent QCA draft decision on the 2014 Draft Access Undertaking MAR, where the QCA has stated the WIRP stage 1 volume forecasts for the 2014 DAU tariffs will only reach 10.8Mt by FY17. It is unclear to Vale what volume forecast the 90% is based on and whether socialisation would still be considered appropriate if based on the QCA WIRP stage 1 volume forecast of 10.8Mt. Vale is concerned that this approach will also lead to a reduction in Aurizon's WIRP risk which is not consistent with the benefits Aurizon are already receiving through the additional access conditions.

As Aurizon Network chose to operate under a separate commercial arrangement with WIRP customers that sought additional access conditions to compensate them for perceived additional risks of the WIRP project, Vale believes any WIRP pricing decision must consider this previous arrangement, and Vale does not believe it would be fair or consistent if a WIRP pricing decision lowered the risk for Aurizon, but maintains the benefits that they have gained from additional access conditions provided to compensate them for the perceived WIRP risks. Vale also believes that it is important that any pricing decision does not transfer any risks from WIRP customers and Aurizon to any existing customers

**Simplification of Standard Access Agreement**

The QCA has sought comments from stakeholders on their views on the benefits of adopting a simplified approach to the standard access agreements. There are currently four standard access agreements that form part of the Aurizon Network UT4 submission which have been developed over time to accommodate different contracting scenarios. The QCA has asked the question of whether all of these standard access agreements need to be retained in UT4

One option proposed by the QCA would be to maintain the End User Agreement and Train Operator Agreements that were established under Aurizon's 2010 Draft Access Undertaking. The End User Agreement and Train Operator Agreement were established to separate the access rights from train operations and have been recently developed following extensive consultation. Vale does believe there would be merit in a simplified approach and the End User Agreement and Train Operator Agreement would be a useful precedent for simplication

For further information regarding this advice please contact myself on (07) 3136 0923.

Yours sincerely,

Anneliese Mattos
Manager Logistics Development
Vale Australia Pty Ltd