BMA

BHP Billiton Mitsubishi Alliance

Aurizon Network's 2014 DAU – Response to QCA's Draft Decision

Introduction

BHP Billiton Mitsubishi Alliance (**BMA**) welcomes the opportunity to comment on the Queensland Competition Authority's (**QCA**) Draft Decision on Aurizon Network's 2014 Draft Access Undertaking (**2014 DAU or UT4**).

BMA has worked collaboratively with the Queensland Resources Council (**QRC**), as part of the QRC's 2014 DAU steering committee and working group and generally supports the QRC's submission in response to the QCA's 2014 Draft Decision. This response is intended to highlight issues in the Draft Decision that are of particular importance to BMA and are over and above those expressed in the QRC's submission. BMA would like to make the following high level comments about the QCA's Draft Decision:

- BMA supports the QCA's overall approach in its Draft Decision to increase transparency and information flow between Aurizon Network, mining companies and train operators. BMA supports the QCA's proposal to conduct a comprehensive review of the pricing framework as part of the approval of Aurizon Network's next undertaking (**UT5**).
- BMA supports the QCA's ongoing efforts to simplify the undertaking and pricing arrangements. However, it is important to BMA that simplification does not drive changes in tariffs or pricing principles that result in perverse commercial implications for investments in the Central Queensland Coal Network (**CQCN**).
- The Draft Decision presents a number of relatively significant departures from Aurizon's proposed approach to developing tariffs (e.g. expansion pricing and pricing of new spurs and treatment of private infrastructure); these changes were not discussed or flagged with stakeholders prior to the release of the QCA's Draft Decision. BMA would welcome the opportunity for earlier consultation on these issues moving forward.

1. Caval Ridge – Pricing principle and tariffs for new train services

The QCA's 2014 Draft Decision includes a significant shift in the way tariffs for new train services are proposed to be calculated under 2014 DAU. The proposed change has been applied retrospectively to determine a new tariff for Caval Ridge train services that will apply from the day first train services began in April 2014. This new proposed tariff will be approximately 50% higher than what it would have been if the tariffs were calculated using the 2010 approved access undertaking (UT3) pricing principles.

BMA objects to the change in the treatment of dedicated rail spurs. The submission explains the reasons for BMA's concerns.

The QCA approved Transitional Tariffs for Caval Ridge in October 2014. Those tariffs were calculated using the UT3 pricing principles. At this time the QCA did not provide BMA with any indication that a major change to the pricing of new spurs was being considered as part of the UT4 decision or that such a change would be applied retrospectively to the Caval Ridge load point. The QCA's October 2014 decision on Caval ridge train services stated that, "*Our approval of the Caval Ridge to HPSCT proposal is based on our assessment that the:*

- *proposed discounts to reference tariffs have been accurately calculated; and*
- *proposal has been determined in accordance with UT3, including the UT3 pricing principles*".

BMA considers that the retrospective application of UT4 pricing principles to Caval Ridge is in direct conflict with the key objectives of the *Queensland Competition Act 1997* (**the QCA Act**) and is an example of an adverse regulatory risk. In BMA's view, the proposed new approach for calculating tariffs for new train services is inconsistent with the objective of Part 5 of the QCA Act, as it does not appropriately balance the interests of access seekers and access holders.

Retrospective application of UT4 pricing principles to Caval Ridge private infrastructure

The QCA's 2014 draft decision states that, "*The Caval Ridge to Hay Point Service Coal Terminal (**HPSCT**) train service qualifies as a new loading point under clause 6.3.1 of our proposed amendments to the 2014 DAU. Specifically, this train service commenced operations in the 2014 DAU regulatory period*[1]". BMA notes that the new tariff is a retrospective increase of approximately 50% in freight costs, which adversely affects the commercial viability of the mine. In BMA's view the magnitude of the change in approach is in direct conflict with one of the key considerations to be taken into account under s138 (2) (h) of the QCA Act, being:

- "*Predictability − the regulatory arrangements should be as stable and predictable as possible given other objectives. Stability and predictability are likely to promote confidence in the regulatory arrangements and economic efficiency by reducing uncertainty associated with long-term investment decisions*"[2].

As noted in the QCA's 2014 Draft Decision, "*Stakeholders should have access to sufficient information to ensure they can efficiently plan their operations and minimise costs, including in relation to proposed expansions*"[3]. Retrospectively changing the approach to the pricing for Caval Ridge train services to HPSCT directly conflicts with this objective.

BMA's investment in Caval Ridge and the negotiation of its access occurred during UT3 under the terms of the UT3 and all investment decisions were made based on prices which were estimated using the UT3 pricing principles. At no point was BMA given an indication that there would, or could, be major changes to the pricing of the spur that should be taken into account. Specifically:

- At the time of the first railing in April 2014 the, 2010 Access Undertaking or UT3 was in effect on the basis of an approval to extend to 30 June 2014 that was granted by the QCA in May 2013. This extension noted that one of the key principles taken into account in making this decision was to provide certainty for all parties for access charges for 2013-14. The 2010 Access undertaking was further extended in June 2014 to 30 June 2015.
- No significant change to the approach to developing new reference tariffs was flagged over his period by Aurizon Network or stakeholders and on 23 October 2014 the QCA approved Transitional Tariffs for Caval Ridge train services on the basis of the UT3 pricing framework, without reference to a likely change in the pricing methodology.
- As detailed in the investment timeline below, the key decisions about whether or not to invest in the mine and how the spur line should be funded were made on the basis of the UT3 pricing framework.

[1] *QCA (2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume III, Pricing and Tariffs, p. 405.*

[2] *QCA (2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume I, Governance and Access, p. 44.*

[3] *QCA, (2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume I, Governance and Access, p. 4.*

Table 1: Timeline of Caval Ridge Mine and Spur Development

Event	Timing
Access agreement signed with Aurizon	September 2010
Caval Ridge spur line contractor appointed	November 2012
Mine operations commence	April 2014
Aurizon Network submitted tariff proposal	August 2014
QCA approved Aurizon Transition tariffs	October 2014
Proposed revised pricing approach,	January 2015

If the UT4 approval process had been completed in a timely manner Aurizon Network would have produced the 2014 DAU for comment in 2012 and the QCA would have produced its Draft Decision in early 2013. Under this scenario there would have been adequate time to adjust any decisions with respect to the negotiations for the access agreement, development of the mine and mine spur on the basis of proposed changes to pricing of spurs. Importantly, if there had been any indication the proposed pricing approach might be introduced BMA may have brought forward its investment decisions and/or asked Aurizon Network to build the spur to lock in the UT3 pricing principles. By retrospectively applying the UT4 pricing principles to FY14 the QCA is significantly increasing the regulatory risk of operating in CQCN given the extensive delays in the regulatory decision making process that appear likely to continue through to the approval of Aurizon Network's UT 5 undertaking.

Proposed approach for pricing of new spurs under the 2014 DAU

The QCA's Draft Decision to exclude all new spur costs from the regulatory asset base (**RAB**) and charge new mines the full reference tariff is a significant shift from QCA's previous position where new spurs were charged a minimum contribution to common cost plus the incremental cost of the spur.

This decision appears to have been made in the interest of simplicity to remove the problem of dealing with how a spur was funded. The price in terms of the QCA's other prime objective, equity is however, significant. Spur lines of existing users are classified as common costs and included in the RAB. Therefore, if a new mine's spur is excluded from the RAB and they are charged the full tariff they will effectively be cross subsidising existing users.

BMA does not consider that such a radical departure from the UT3 pricing approach is justified. Previously, if a miner had a relatively expensive spur, a new mine spur had to pay the minimum contribution to common cost plus the cost of their own spur. Under the revised approach, the new users must pay the full tariff plus the full cost of their spur. The effective tariff increase depends on the system but will result in a 75% increase in AT3 and AT4 for the majority of new spurs.

The key factors used to support the decision was an unreferenced statement that Aurizon Network had difficulties gathering information about the cost of private spurs from individual miners and a comment that private incremental costs are not subject to an independent assessment of prudency.

BMA disputes the claim that Aurizon Network had difficulty obtaining information on the cost of the spur as Aurizon Network was provided all the information it required in a timely manner. In terms of prudency, this information can be audited and independently assessed in the same manner that the QCA currently audits and independently assesses the Aurizon Network's capital expenditure costs.

BMA agrees that the application of the UT3 pricing approach was potentially complex because of the requirement to independently identify the costs of a new mines spur assets in the RAB and its impact on system pricing on an ongoing basis. This complexity was independent of who financed the spur. If, in the interests of simplicity, it is decided that all new spurs should be excluded from the RAB (independent of the financing) BMA considers it important that the principle of contribution to common costs is maintained. It provides equity for new users who would otherwise be paying for existing users spurs and it helps facilitate investment by lowering the entry cost of new miners, particularly during the critical ramp up period when average costs per tonne are very high.

As noted by the QCA in its Draft Decision, the proposed pricing approach is "*consistent with our proposed approach to expansion pricing*[4]" i.e. where the incremental cost of providing access is greater than the access charges facing users under the reference tariffs no contribution to common cost (**CCC**) is required but if the applicable reference tariff is higher than the incremental costs, the existing reference tariff will be applied[5]. This approach makes some sense when pricing expansion users because, by definition, these users will have invested in the mainline as part of their upgrade. In the case of expansions, even if the existing reference tariffs are applied, the full value of the reference tariffs would not go towards reducing the tariffs of the existing users, some part of it would go towards paying off these mainline upgrades. In the case of a new spur no (or very limited) investment in the mainline is required and all the revenue derived from the new user is effectively returned to the existing users. Under no scenario could this occur if an expansion occurs.

The application of the expansion pricing principles to the pricing of new spurs when the cost of the spur is excluded from the RAB and no investment in the mainline is required is inconsistent with the objective of Part 5 of the QCA Act, as it does not appropriately balance the interests of access seekers and access holders. It is also unlikely to promote efficient investment in the CQCN because as long as new users are making a contribution to common cost, existing users are better off if a new mine begins operation. As such it is in the interests of existing users to incentivise new mine operations.

If spur costs are to be excluded from the RAB, a preferred approach would be to price new spurs using the CCC formula agreed in UT3 (AT2 plus 25% of AT3 and AT4). This would:

- ensure existing users are better off when a new user enters the market;
- be consistent with Part 5 of the QCA act by helping promote efficient investment in the CQCN; and
- avoid the problems associated with the retrospective application of UT4 decisions.

To appropriately balance the interests of access seekers and access holders in the longer term, the discount to AT3 and AT4 could reduce over time (perhaps 10 years). The justification for the price discount time for new access seekers is greatest during the early ramp up years and if no new spurs are added to the RAB the equity arguments in favour of discount for new access seekers will fall away over time.

[4] *QCA (2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume III Prices and Tariffs, p. 382.*

[5] *QCA(2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume III Prices and Tariffs, p.382.*

Table 2: Summary of Key Issues

QCA's rationale for proposed change	BMA Comments
Caval Ridge began railing in UT4	While Caval Ridge began railing in UT4 (April 2014), all the critical decisions with respect to how and when the spur was built and financed were made under UT3.
Aurizon Network has difficulty getting information about the cost of private spurs from miners	BMA cooperated closely with Aurizon Network when asked to provide information on the capital cost of spurs
Private spurs are not subject to an independent assessment of prudency	The information on the cost of spurs that was provided to Aurizon Network could also be provided to an independent expert to assess prudency (in the similar way to how Aurizon Network's capital costs are assessed as part of capital expenditure approval process)
The revised pricing approach is simpler than the approach proposed by Aurizon Network	Simplicity is not a sufficient justification for what is effectively a 50% increase in the Caval Ridge tariff
The proposed approach is consistent with the QCA's proposed approach to expansion pricing	Principles designed to protect existing users from the impact of a major expansion are not necessarily applicable to the pricing of mines where the cost of the spur is explicitly excluded from the RAB

2. Major expansion pricing

In BMA's submission to the QCA on Aurizon Network's proposed new reference tariffs for train services to Wiggins Island Coal Terminal (**WICET**) it was recommended that pricing for train services to WICET should:

- be based on efficient and prudent costs;
- be based on realistic volume forecasts;
- ensure there is no cross subsidisation between users;
- not commercially disadvantage existing users; and
- not increase commercial uncertainty for existing users through increases in tariffs or take or pay liabilities.

BMA supports the application of above principles for expansion pricing under UT4. However, BMA is concerned that the socialisation principles outlined in the Draft Decision[6] do not sufficiently clarify when socialisation will occur. BMA considers that further clarity is required in relation to:

- How sustaining capital expenditure will be dealt with post expansion; and
- If the decision to not contribute to the common costs of an existing system, will be reviewed over the life of the project.

Sustaining capex is likely to become material over time as the value of the existing assets depreciates. The final decision will need clear guidelines that detail how sustaining capex will be capitalised across two (or more) systems that share the same infrastructure. One option would be to allocate expansion capex according to the same principles used to allocate expansion capex between systems following construction i.e. percentage of paths utilised by each user group.

[6] *QCA(2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume III Prices and Tariffs, p.374.*

BMA has some concerns over the practicalities over the application of the $ per tonne socialisation test given the decision to ask new users make zero contribution to common cost. To date the expansion tariffs have included the cost of both network extensions and enhancements to the existing network. If an expansion involves a major network extension and the socialisation test is a simple comparison of two tariffs on a $ per tonne basis then socialisation will only occur when the tariffs of the longer haul expansion users are roughly equal to the tariffs of the shorter haul existing users. Is this the intent? Or will the test be adjusted for factors such as, differences in haul length?

3. Capital expenditure allocation and approval process

BMA supports the QCA's amendment of Aurizon Network's capital expenditure approval process. The requirement for end customers to vote on a broader package of project measures including scope, standard and cost will enables customers to better assess the merits of the project. This also removes regulatory uncertainty for Aurizon Network, financiers and existing and future users.

BMA reiterates its view that there should be complete transparency in the allocation of capital expenditure or project costs and the corresponding benefits between systems.

BMA notes that the current annual capital expenditure process provides information about an engineering assessment of the projects to be included in the RAB and additional financial information. However, it is very difficult to verify that the value of the assets actually included in the RAB is consistent with these reports. For example, the QCA's final approval of Aurizon Network's 2011-12 capital expenditure included in it a table that listed the items approved but did not specify which system the assets would be included in. Neither does the decision itemise the asset replacements. The QCA's 2012-13 final decision on capital expenditure listed the projects by system and included $64.5m of system wide projects without any reference to how these would be allocated between systems.

To improve the transparency of the process and ensure that any user can verify that the opening value of any new asset in the RAB is consistent with values approved by the QCA, BMA considers that it would be useful if:

- the annual approval process specified which system each asset would be capitalised in, how much construction finance interest was included in the published estimate figure and when it was assumed that the assets would be capitalised into the RAB;
- the asset roll forward at the end of each regulatory period included a direct link between the approved amounts in the final capex figure; and
- the timing of the cash flow for each project was made public in a spreadsheet along with the calculation of construction finance interest.

BMA considers that this will not only provide transparency but also enhance confidence in the regulatory process by ensuring that producers are not cross subsidising the users and systems.

4. Relinquishment fees – deterrent to efficiency improvement

As the QCA is aware, supply chain participants are currently working together to improve the efficiency of the network through the introduction of new operating practices. This is a collaborative process intended to develop and test new ideas. Initiatives that are shown to be effective through this process are expected to be adopted across the network for the benefit of all users.

BMA considers that the QCA's refusal of Aurizon Operation's request to have the right to waive relinquishment fees where additional paths are created by the application of more efficient operating practices (e.g. longer trains) is likely to significantly reduce investment in this research. The QCA made this decision on the basis that:

- any participant considering changes to its operations would examine the benefits of changing its operations versus the costs of doing so. This would include weighing up the benefits of pursing efficiency improvements against the cost of making those improvements — which includes potential relinquishment costs; and

- waiving relinquishment fees would be a concern where there is no alternative demand which means costs would transfer to other access holders[7].

Given the potential materiality of relinquishment fees, user may be deterred from pursuing incremental efficiency gains. As noted by Aurizon Operation in its submission[8] this conflicts with a number the statutory criteria associated with the regulatory framework and the requirements of s168A of the QCA Act, particularly where it can be shown that the efficiency improvement being implemented will benefit all users on the system over time.

As it currently stands the relinquishment fee could punish early adopters of technological improvements. BMA considers this to be an undesirable position and submits that there should be scope for the relinquishment fee to be waived where it can be shown that the efficiency improvement being adopted has the potential to benefit all users over time e.g. the adoption of longer trains which create additional train paths.

5. Contract renewals

BMA supports the QCA's proposed changes to the renewals process that reinstate the high priority given to renewals through the capacity queue process. Users require a regulatory environment which provides them with long term certainty of access.

BMA notes that recent development of ports on both the CQCN and Hunter Valley coal networks have shown that competing ports can be developed at what is effectively the same location as the existing port (e.g. the Newcastle Coal Infrastructure Group's development at the Port of Newcastle and the WICET development at Gladstone). When this is the case a user may wish to renew a contract to, for example, transport coal to Gladstone, but use a different port provider. Importantly, the below rail network cost in terms of train paths will effectively be the same for both options.

At present, the renewal process locks a user into a renewal to the same port or destination. Where it can be shown that the below rail impact of serving one port terminal or another is effectively the same, BMA considers a user should be given the same renewing contracting rights even if they wish to transfer from one terminal to another.

6. Short term transfer provisions

BMA welcomes QCA's proposed review of the treatment of short term transfers. Short term transfers are the means by which users can efficiently manage the cyclical flow of mine production within what would otherwise be a relatively inflexible, rigid below rail contracting environment. BMA also supports the development of a short term capacity transfer mechanism and is supportive of Aurizon Network's proposal of introducing incremental changes (subject to these being further reviewed by the QCA after initially testing).

Before approving any short term transfer provisions, the QCA must ensure that the provisions are sufficiently flexible and that there are no superficial restrictions that prevent maximum utilisation of existing rail infrastructure. In this respect, BMA has the following concerns about Aurizon Network's existing proposal.

[7] *QCA(2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume II, Capacity Expansion, p.235.*

[8] *Aurizon Operations(2014), Submission letter to the QCA.*

- *Aurizon Network Proposal* - 25% maximum limit on total TSE's that can be transferred in an access holder's access agreement during a year.
    - BMA believes that this limitation is overly restrictive and could limit the efficient utilisation of the network. It appears to have been introduced to provide protections against potential gaming opportunities but BMA considers this risk could be managed more effectively and efficiently through alternative policies. For example, approved transfers on a rolling basis only if the transferred paths have been utilised. BMA considers that retaining the limitation will not ensure greater utilisation of the network.
- *Aurizon Network Proposal* - Short term transfers being conditional on a common destination particularly within a system.
    - If the various elements of the supply chain are able to accommodate a proposed transfer request, it should be accepted even if the destination coal terminals are different. This will allow transfers between Dalrymple Bay Coal Terminal and HPCT in the Goonyella system and potentially WICET and RG Tanna Coal Terminal in the Blackwater system. BMA considers that users will benefit materially from having the flexibility to alternate between unloading facilities.
- *Aurizon Network Proposal* - Short term transfers will only be permitted where the transferee's train services have access charges based on the same reference tariff as that used in respect of access charges for the transferor's train services that are the subject of the short term transfers.
    - BMA considers that this requirement may make the short term provisions very restrictive. This is especially the case in light of the proposed expansion pricing currently being considered, as within a system each expansion may be looking at a separate set of reference tariffs.
- *Aurizon Network Proposal* – The short term transferee operator to confirm that it has sufficient capacity to rail 100% of the short term access rights and all other access rights for train services which it operates.
    - BMA supports the QRC's view that the requirement for the short term transferee operator to confirm that it has sufficient capacity to rail 100% of the short term access rights and all other access rights for train services which it operates is too onerous and should be removed.

7. Incentive for cost or efficiency savings

Aurizon Network's previous access undertakings relied on the CPI-X adjustment to costs that built up the Maximum Allowable Revenue (MAR). In BMA's view, this proved to be an ineffective mechanism for incentivising improved performance by Aurizon Network, evidenced by Aurizon Network not being able to demonstrate any material improvement to its maintenance costs in its 2013 DAU and by putting forward an operating cost estimate which was almost double the cost of operating the network in UT3.

While the QCA and Aurizon Network continue to rely on crude benchmarking metrics to evaluate performance, it is difficult to see what information could be used to judge Aurizon Network's performance with sufficient rigour and independence.

BMA notes that the QCA removed the CPI-X efficiency factor from its maintenance and operating cost build up approved in its Draft Decision on MAR. This decision was made despite Aurizon Network providing only very high level information on the productivity improvements it has built into its forecasts and without Aurizon Network providing specific detail on how these improvements had been identified and would be implemented. BMA has concerns about an incentive mechanism being based on metrics which are high level and immeasurable.

While BMA broadly supports the use of incentive mechanisms to drive efficiency, BMA submits that these mechanisms should only be put in place after Aurizon Network has committed to providing users with independently verified metrics for measures of labour and asset performance on a regular basis. It would then be expected that Aurizon Network would publish targeted strategies that it was putting in place for review by the QCA. This applies equally to increment payments that Aurizon Network is entitled as per to the increment provisions contained in Part B schedule F or the 2010 access undertaking.

BMA notes that the QCA has asked that a process for developing an incentive mechanism be included in a revised undertaking (Draft Decision 3.6) and the Draft Decision includes a long list of requirements for this mechanism. Given the time available before the proposed commencement of UT4, BMA considers that a more targeted requirement for the development of an incentive mechanism be included instead. This targeted approach is more likely to be achievable prior to the end of UT4 and could be revised at a later date.

8. Tariff review process

BMA understands that the QCA is proposing to undertake a full review of the tariff structure for UT5. BMA supports such a review given the complexity of the existing system. In BMA's view, the current system does not provide appropriate pricing signals for users, for example:

- AT2 tariff component is not achieving its aim of effectively pricing incremental paths and should be removed; and
- AT1 tariff component continues to be a crude tool for linking network activity and maintenance costs particularly when actual activity diverges significantly from forecast. The review should include an assessment of alternative mechanisms as well as changes to the quantum of the AT1 tariff.

BMA hopes that simpler structures for both the tariffs and take or pay regimes can be achieved from the UT5 consultation process. BMA would like to reiterate that the pricing structure and principles are complex commercial issues, with direct financial implications. It is therefore important that careful consideration and consultation be undertaken with industry to avoid any unintended commercial consequences.

9. Non-coal carrying train services

Currently, the QCA relies on the costing manual framework to apportion costs associated with the declared services and the non-coal traffic. The last review of Aurizon Network's costing manual was conducted in October 2013.

In BMA's view, the existing framework governing pricing and costing of non-coal traffics lacks clarity and transparency. Currently, users do not have access to the information required to validate Aurizon Network's claim that the revenue it receives from these traffics is immaterial.

BMA welcomes the proposed review of the costing manual. In BMA's view, the review should also be accompanied by an audit of the actual revenues derived from non-coal traffics on the coal network to provide the transparency required to justify the assumption that an appropriate adjustment to costs has been made. If such audit reveals that revenues derived from non-coal traffics are found to be higher than estimated costs, consideration should be given to using the revenue figure rather than estimated cost figure to adjust Aurizon Network's CQCN maximum allowable revenue.

10. Allocation of GAPE approved capital expenditure

BMA notes that the QCA in its Draft Decision has sought to allocate capital costs to the GAPE system that were previously capitalised in the Newlands system[9]. Aurizon Network has consistently stated that a portion of the Goonyella to Abbott Point Expansions (**GAPE**) project costs would have been incurred even if the GAPE project did not go ahead. For example, the 2010 DAU or UT3 included the following statement:

'*In these revised forecasts, Aurizon Network has included $40 million of expenditure in 2011-12 for ballast upgrades. While this expenditure had been identified as part of the Newlands upgrades associated with GAPE, this expenditure would have been required even if GAPE did not proceed. This expenditure will not increase volumes however will improve the quality of the ballast which is necessary to improve the integrity and performance of the network in the long term'*[10].

BMA agrees with the QCA's assessment that Aurizon Network's justification for capitalising $30.3m into the Newlands asset base was not robust. Aurizon Network appears to have simply taken the difference between the non-GAPE related capital expenditure[11] spent on the Newlands system in UT3 and Newlands the capital indicator value and assumed that the remainder is the how much would have been spent on the system in the absence of the GAPE project. No detailed evidence is provided for this assumption.

The cost of upgrading the ballast was clearly significant. According to the detailed breakdown of GAPE project costs provided in Sinclair Knight Merz's (**SKM**) Capital Expenditure 2011-12 Engineering Assessment report, $42.9m (excluding IDC) was spent on formation and ballast upgrades[12] in the Newlands system as part of the GAPE upgrades. In addition, $4.3m (including IDC) was spent in 2011-12 on a project labelled ballast replacement on the Newlands system (A.04055). This project is subject to a specific assessment in the SKM report but this assessment does not make it clear why this project was captured separately.

BMA notes that Aurizon Network is poorly incentivised to ensure that this capex is correctly allocated. However, this directly impacts GAPE regulated tariffs as 81% of the $30.3m that was allocated to the Newland regulatory tariffs will be allocated to GAPE users.

11. Baseline Capacity and capacity deficit guarantee

BMA supports the QCA's approach to undertaking a baseline capacity review of the CQCN that clearly outlines the assumptions used to determine the network capacity. The current system lacks transparency and a clear determination would avoid issues such as the classification of the Blackwater duplications as being required to cater for existing contracted capacity or the expansion customers.

While BMA supports both the notion of a capacity deficit guarantee and the requirement that Aurizon Network undertake and fund any expansion required to meet contracted capacity, its application will need to be carefully considered. BMA believes that the QCA must carefully assess the various scenarios before obligating Aurizon Network to undertake expansions.

12. Conclusion

BMA supports the majority of QCA's 2014 Draft Decision and considers it to be a significant improvement on the proposal put forward by Aurizon Network. Our major concern is with the proposed approach to the pricing of new train services and its retrospective application to Caval Ridge, we also note that there are a number of areas where we consider that while the principles being applied by the QCA are sound but their practical application could be improved, particularly with respect to:

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[9] *QCA(2015), Aurizon 2014 Draft Access Undertaking - Draft Decision Volume III, Pricing and Tariffs,p.400*

[10] *Aurizon Network (2010), 2010 Draft Access Undertaking, Volume 1 – Policy Issues, 14 April 2010, p.72.*

[11] *SKM (2013), Capital Expenditure 2011-12, Engineering Assessment, p. 10.*

[12] *SKM(2013), Capital Expenditure 2011-12, Engineering Assessment, pp. 198-203. (Project codes A.03473.29000 and A.03473.47000)*

- the pricing of major expansions; and
- short term transfers provisions.

It is important to note that the policy and principles instilled under UT4 (once finalised) will have a material effect on the viability of mines in Queensland and major investment decisions in the industry. Accordingly, it is critical that the QCA consider all matters in assessing the DAU process to ensure:

- that there is a full understanding of commercial implications and potential unintended consequences prior to a final determination; and
- commercial uncertainty (including potential liabilities and risks) is minimised, particularly at a time when the coal industry is actively reducing costs and implementing productivity measures to remain commercially viable and globally competitive.

To achieve this aim BMA would welcome future opportunity to consult with the QCA and would encourage the QCA to consult widely with stakeholders prior to making major changes to the regulatory framework.