



17 April 2015

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) – Policy and Pricing
Draft Decision**

Vale Australia Pty Ltd (**Vale**) welcomes the opportunity to provide a submission to the Queensland Competition Authority (**QCA**) in respect of its draft decision on the policy and pricing aspects of Aurizon Network's 2014 Draft Access Undertaking (**2014DAU**).

Executive Summary

Vale has been an active participant in the Queensland Resources Council's (**QRC**) efforts to develop an agreed industry position of the 2014DAU QCA draft decision. 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 supports the draft decision of the QCA to not approve the 2014DAU. Vale believes the 2014DAU is unbalanced and requires substantial changes to rebalance the undertaking to provide a framework that promotes the efficient use of the rail network. Vale generally supports the QCA's approach to promote greater transparency and the proposed QCA amendments to the 2014DAU. Vale believes the proposed QCA changes identified in its draft decision would significantly improve transparency and the accountability in the rail network, and greatly contribute to the efficient use of the infrastructure. Vale believes the push by the QCA to promote greater transparency has already impacted positively as Aurizon has commenced a greater level of communication on various matters that is helping increase the level of understanding of the rail network. Vale supports and encourages the continuation of this level of communication and engagement by all stakeholders to promote productivity improvements across the rail network. Vale believes productivity improvements across the Central Queensland Coal Network will be important in assisting coal producers, and the Queensland coal industry generally, remaining competitive in the current low coal price market environment. Vale believes that productivity improvements will only be realised when there is a greater understanding of the problems faced by each stakeholder and there is an effective engagement between them to resolve these problems in mutually beneficial manner.

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Vale believes the amendments proposed in the QCA's draft decision will promote greater transparency and accountability through the inclusion of the

- non-discriminatory obligations across all parts of the undertaking,
- basing the ring fencing provisions on the terms in the previous undertaking,
- Establishing baseline capacity assessments,
- Improving reporting information and timing, and
- Simplifying the dispute resolution provisions.

Market Context

The 2014DAU is being developed in a period of significant change in the coal market that is adding additional pressure on a transparent and balanced approach across the coal chain. The most significant changes to the current market conditions are Aurizon's privatisation and the movement of the coal industry out of the previous growth cycle to a productivity cycle. As highlighted throughout the 2014DAU, Aurizon are challenging the positions reached in previous undertakings on the basis of a concern for their legitimate business interest. Vale believes Aurizon's interpretation of legitimate business interest appears to almost solely be based on higher returns to shareholders with little consideration of the low economic and commercial risks that Aurizon face in gaining those returns. At the same time, the coal industry is undergoing significant productivity programs within their operations and are seeking similar productivity improvements from its service providers to ensure the coal industry in Queensland remains competitive in the global coal market.

2014DAU

Vale supports the detailed QRC submission that has been developed with the support of coal producers. Vale would also like to provide further details on the QCA's draft decision.

Part 2 Intent and Scope

- Vale supports the QCA's decision to re-instate the non-discriminatory treatment clause and the inclusion of general principles of non-discrimination and independence across the activities governed by the undertaking and not just the ring fencing provisions. Vale believes this is an important principle that must be maintained to ensure efficient access to the rail network
- Vale supports the QCA's revised wording that provides a stronger obligation on Aurizon to procure and maintain the Ultimate Holding Company Deed.
- Vale supports the inclusion of a dispute resolution mechanism for disputes arising in respect of electricity supply as this is a critical issue for producers and train operators on an electrified system such as Goonyella. Significant business decisions have been made by various stakeholders within the electrified systems to enter long term take or pay contracts for the operation of a specific train configuration. The lack of an absolute obligation for Aurizon to supply electric energy to an Access Holder presents a risk to a train operator, and its customers, and the coal system generally.

- While Vale supports the concept of introducing an incentive mechanism as a key factor in improving productivity it does have concerns about the practicality of this process given the time remaining within the undertaking period. Aurizon operates under a revenue cap form of regulation that includes very little risk for them both financially and operationally. Vale believes this is clearly demonstrated within the Goonyella System that continues to operate substantially below its contracted capacity, however, Aurizon continues to earn its revenue cap as the capacity loss is ambiguous and difficult to attribute to any one component of the supply chain. Although not seeking to attribute this loss to Aurizon, it does present a significant issue in determining an appropriate incentive mechanism and the problems that will be encountered to set the baseline, and the assessment of the performance to be measured against this baseline. A key question to be resolved is, what is the baseline measurement for an incentive, and should Aurizon be rewarded if the contractual position is not achieved? If so, how do you measure what this should be as the system losses that limit capacity are generally difficult to allocate to any individual stakeholders? The availability and transparency of information used in determining any incentive will also play a significant part in the perception of an incentive being fair between Aurizon and its customers. As stated above, Aurizon will achieve their revenue for the contractual capacity so the provision of a further incentive when the contractual position has not been achieved and the losses that have limited this capacity are not clearly attributable, requires a deal of caution to the incentive mechanism that is established. Vale believes these issues have a significant impact on an incentive mechanism as Aurizon has a low risk of failure to achieve contractual revenue, so an incentive must include an active outperformance of contractual positions and not just a redistribution of contractual capacity not utilised by its customers. Vale believes that an incentive mechanism should be considered as part of the next undertaking after robust engagement between Aurizon and stakeholders to seek potential solutions to this very complex area.

Part 3 Ring fencing

- Vale supports the stronger ring fencing obligations inserted by the QCA. Vale believes ring fencing is a difficult issue to assess in terms of effectiveness based on a claim for a breach. Vale agrees with the QCA view, that a lack of complaints could result from many factors, but as the potential cost of a breach may not be easily remedied, it is important to maintain a strong ring fencing framework. A failure of the ring fencing provisions is likely to have a significant impact on the stakeholder(s) suffering from the breach so Vale does not believe these provisions can be reduced just because there has been no or limited reports of breaches. Vale believes that there is a compelling argument that an efficient ring fencing provision should lead to few complaints and ultimately the assessment of effectiveness is likely to be based on its perceived credibility amongst stakeholders.
- Vale supports the view that an effective ring fencing regime is critical to promoting efficient competition in upstream and downstream markets and customer confidence and trust in Aurizon's actions. Vale believes historically stakeholders have not been provided with clear and transparent information which has led to significant concerns as to whether Aurizon is operating in a fair and non-discriminatory manner that promotes competition. Vale believes this level of transparency is important, as without sufficient information it is difficult to gather enough evidence to support a claim for a breach of the ring fencing provisions. Vale supports the QCA's proposed changes on secondments and temporary transfers, training, and the confidential information register as it believes this greater level of transparency needs to be provided before a true assessment can be made of the ring fencing provisions. Vale believes ring fencing will continue to be a significant factor as the Aurizon organisation evolves and functions are now being corporatized within the Aurizon group as well as secondments between the corporate entity and the regulated business. Vale believes the level of confidence of appropriate ring fencing is being highlighted by

simple changes in the Aurizon Group that now includes standard stationary and email accounts across the business compared to the historical approach that included separate identification of personnel employed by, and correspondence from the regulated business.

- Vale supports QCA's requirement for the establishment of a confidential information register as Aurizon is seeking more data and information from Access Holders and Access Seekers so it is important that these provisions are tightened to maintain confidence that the confidentiality of this confidential information be maintained.
- Vale supports the continuation of ring fencing training requirements as there appears to be regular personnel movements between the regulated and non-regulated companies.

Part 4 Negotiation Framework

- Vale supports the QCA's amendments to clause 4.9.1 that allows greater flexibility to the underlying customer on how it will progress its access application with Aurizon.

Part 5 Access Agreements

- Vale supports the QCA's approach to simplify the number of access agreements included in the undertaking. Vale believes this is the appropriate time to conduct a full review on the new standard agreement to ensure operational efficiency and appropriate risk allocation as the review is not constrained by historical agreements.
- Vale supports the QCA's approach to ensure that appropriate matters are dealt with either in the standard access agreement or the undertaking, or both to ensure a robust and consistent approach to access across the rail network.
- Vale believes the Standard Access Agreement should contemplate the development and inclusion of a short term transfer mechanism. The QCA is currently reviewing the short term transfer mechanism that has been developed by Aurizon under a separate process but Vale believes there is benefit in introducing the concept within the Standard Access Agreement to assist the facilitation of transfers if a mechanism can be agreed in the future.

Part 6 Pricing Principles

- Vale supports the price differentiation principles outlined in the QCA's draft decision. Specifically, Vale agrees with the average down/incremental up pricing principle for new expansions on the rail network. Vale believes this approach recognises the costs and risk of the existing Access Holders and mitigates their exposure to cost increased imposed by the new expansion, while also providing benefits for existing Access Holders if the price would decrease, to represent the value of their initial contribution to establish the network. Determination of the expected expansion pricing used to determine if an expansion is socialised or not will be an important factor in this process. Vale believes that any pricing approach will eventually result in all users being consolidated within the socialised customer based as their expansion tariffs progressively move closer to the socialised tariff over time. The key to be resolved is the transitional period of time when an expanding user's tariff is above the socialised tariff either due to low volumes or higher capital expansion costs. Vale appreciates that the QCA's approach is designed to cope with the

multiple take or pay provisions across access undertakings, but is concerned the proposed approach may generate greater complexity as there will be multiple pricing approaches across customers that could provide an impediment for the ability trade capacity. Vale believes one approach could be to amend the QCA approach to establish a separate expansion volume forecast to determine the tariff and take or pay. By establishing a separate expansion volume forecast, Vale believes you generate competing forces of providing a higher volume forecast to produce a lower tariff versus greater likelihood of triggering take or pay. Vale believes these competing forces and the isolated impact of the expansion volume forecast will encourage appropriate expansion pricing as well as providing a flexible assessment process at each reset of the expansion volume forecast to determine when an expanding tariff should be incorporated within the socialised tariff.

- Vale supports the QCA's approach that further consultation with all stakeholders should occur as part of a complete review of the pricing framework, rather than adjustments to particular items during this undertaking period. Vale believes the review of the pricing framework is likely to be a very complex process that will result in winners and losers, and therefore, is likely to require a greater level of transparency of the new pricing framework. Vale believes the review requires active engagement with all parties and the process will need to be very transparent to provide all stakeholders with a clear understanding of the impacts of different approaches on their individual access pricing. Vale supports a simpler approach to setting the Reference Tariffs provided they are cost reflective and there is greater transparency to stakeholders of the flow through of Aurizon's costs to the tariffs. Vale believes engagement with stakeholders for a strategic review of the pricing framework will need to be commenced shortly if the proposal is to amend the pricing framework in the next undertaking.
- The QCA has proposed to reinstate the Access Conditions provisions from UT3 that requires any Access Conditions to be approved by the QCA. The QCA has indicated that this is necessary to avoid the potential for Aurizon to engage in monopoly rent-seeking behaviour. In isolation this amendment is favourable, however as Aurizon has chosen to not include a voluntary funding obligation, Vale does not believe this provides an efficient outcome for the future expansion of the network. While Vale acknowledges that the change proposed by the QCA provides a better balance to this issue than that proposed by Aurizon, it does not support the proposal for Aurizon to be allowed to seek Access Conditions without the provision of a voluntary funding obligation was inserted in UT3 to balance Aurizon's Access Conditions provisions. Including only one component in the 2014DAU will present an unbalanced position that can contribute to significant delays to investments in the network. These delays will potentially allow Aurizon to utilise its position to claim monopolistic rents as time pressures are applied to customers seeking access to the network. Vale is concerned that Aurizon will be reluctant to invest in the network unless they receive above regulated returns and there is likely to be no viable alternative for Access Seekers as the cost of participating in a Standard User Funding Agreement will be limited by the value of the project. If the QCA is minded to retain the Access Conditions, then Vale believes the provisions should be amended to increase the burden of proof on Aurizon to substantiate the financial risks that are being mitigated by the Access Conditions, or there should be a further reduction in the equity beta being provided to Aurizon to reflect this lower regulated investment position.

Vale also believes that the pricing principles and common cost allocation of a project subject to Access Conditions should be considered at the same time as the QCA assesses the financial risks. If Aurizon chooses to seek Access Conditions, it should be required to indicate if it believes existing users gain any benefits from the project and the

likely portion of the project, and the resulting capital costs, that will be allocated to the existing users to reflect this benefit. Vale believes this provides greater certainty to both existing and new users, and is important in the assessment of the financial risks of the project. Vale believes this level of detail is important to establish during the determination of the Access Conditions, so that future submissions are not able to progressively shift the risk profile of the project.

- Vale also supports the QCA's view that an effective trading mechanism is complementary to any structural change in the pricing framework to ensure Access Holders are provided with appropriate mechanisms to make informed decisions on the utilisation of the access they hold.

Part 7 Available Capacity Allocation and Management

- Vale generally supports the QCA's amendments to the Part 7 of the undertaking based on the principle that capacity allocation and management remains transparent to all stakeholders which should lead to more efficient decision making.
- Vale supports the introduction of a short term trading mechanism and believes this should be a different process to a long term transfer. Vale believes that a short term transfer mechanism process should be simple and enable participants to quickly and efficiently transfer capacity. Vale believes a short term transfer mechanism should be designed to assist an Access Holder to manage its access rights in response to short term production fluctuations. Vale believes it would be appropriate to align the short term transfer mechanism with a 12 month period which would align it with Aurizon's annual baseline capacity review and a coal producer's detailed production forecast period. Vale believes this allows the establishment of preapproved transfer areas where Access Holders could freely transfer on an automatic approval basis to improve the efficiency of the transfer system. This should facilitate a simple and quick transfer approval process that would only require the transferor and transferee to provide their respective origins and destinations, and the capacity to be transferred.

Part 7A Baseline Capacity

- Vale generally supports the QCA's proposal to separate capacity related provisions within the undertaking as it believes this emphasises the importance of establishing a transparent assessment of the baseline capacity and the future network development. Vale believes it is vital for the efficient operation of the network to provide a baseline from which future directions and decisions can be made by all stakeholders. The baseline review should be completed using the System Operating Parameters applicable at the time, and if there are variations to one or more of the parameters used in the assessment, a note should be provided outlining the justification for that change in the assumption. Vale believes this increased level of transparency on the system capacity will increase the efficient use of the coal chain. Vale believes this section is likely to require further refinements in the next undertaking as stakeholders gain better knowledge of the process and information used to develop the various train plans and their link with the future network development plans, and ultimately the expansion of the network.
- Vale supports the requirement that any system rules are required to be maintained at all times and required to be approved through the QCA process to allow greater transparency

to all stakeholders. Vale believes this is an important step to ensure that the system rules are not in conflict with the undertaking.

- Vale continues to support the development of a Master Train Plan that will provide greater certainty and transparency that the current level of infrastructure is capable of operating the contracted capacity.

Part 8 Network Development and Expansion Process

- A significant amount of time and effort has been spent on the development of the Standard User Funding Agreement (**SUFA**). As Aurizon has not included a voluntary funding obligation in UT4, it will be important that a customer's ability to use the SUFA is not impacted under the expansion process.
- A clear link to the efficiency of the expansion process will be the establishment of a workable standard studies funding agreement that provides all stakeholders with an opportunity to efficiently move between project development stages. Vale believes the current studies funding agreement is unbalanced and will not provide an appropriate mechanism to assist in the efficient development of a project. Vale believes the proposed changes outlined within the QRC submission are required to provide a degree of balance within this document. Of significant concern to Vale is Aurizon's proposal to include a project management fee, margins on costs, and additional costs within the study costs. Vale believes this creates an opportunity for the recovery of costs more than once as these costs appear to overlap. Vale believes the only costs that should form part of the study costs should be those that are reasonable and properly incurred as part of the study plus a provision of a project management fee. Vale believes there needs to be a mechanisms to ensure there is no double counting of costs claimed within the study costs and those already provided through Aurizon's Maximum Allowable Revenue. Vale also does not support an allowance for a margin to be provided on the study costs as the study funders will be providing loans via a monthly drawdown to underwrite the study and the study costs will incur a rate or return if included within the Regulated Asset Base.

Part 9 Connecting Private Infrastructure

- Vale supports the QRC submission and has no further comments on part 9.

Part 10 Reporting

- Vale supports the QCA's overarching objective to make available meaningful, transparent, timely and relevant information to maintain Aurizon's accountability to stakeholders. Vale believes more reporting and information will provide greater transparency and ultimately more informed decisions by all stakeholders. Vale supports the move to monthly performance reporting within 10 business days as this provides timely advice to both Access Holders and their Customers on the performance of the system. Vale supports the position to provide reports to customers even if they are not the ultimate Access Holder as this will increase the transparency within the network. Vale sees the reporting requirements as evolutionary, as the increased transparency will likely lead to further suggestions for improvements and refinements of the report timing and information

provided to stakeholders. Vale believes this is an area that is likely to require further development in the next undertaking.

- Vale would like to see the expansion of the maintenance reporting to assess actual performance against planned costs and scope to provide greater transparency on the performance of the network planning process. Vale notes that maintenance reporting and maintenance processes are currently being discussed between coal producers and Aurizon to establish a new transparent framework that provides a greater understanding of the maintenance task. Vale believes that further amendments to this section are likely in the next undertaking to reflect the new knowledge gained during the maintenance engagement process.

Part 11 Dispute Resolution and Decision Making

- Vale supports the QCA's position to simplify the dispute process, but believes that there should be no restrictions on matters that may be referred to resolution, or restrictions of the stakeholders that have the right to dispute, to provide a balanced and effective process. Vale believes that having an ability to effectively and efficiently dispute access matters is important given Aurizon's monopolistic position. Vale believes that any restriction or delay of a party's ability to dispute is likely to lead to inefficient behaviour as it will not maintain the accountability of all parties.

Part 12 Definitions and Interpretation

- Vale has not provided separate feedback on Part 12.

Schedules

Schedules A - D

- Vale supports the QRC's submission and has no further comments on schedules A - D

Schedule E

- Schedule E sets out the voting rights for pre-approval of capital projects by Aurizon. Vale believes that the pre-approval process should include a time limit in which Aurizon is then required to commence a project after receiving a vote supporting the capital project. Vale believes the pre-approval process in the past has provided Aurizon with the opportunity to seek a vote and then either delay or not proceed with the expansion. Vale believes to improve efficiency and transparency there should be a mechanism established to remove any favourable pre-approval vote if the capital project does not proceed within a specified time, or it is materially adjusted from the form presented in the pre-approval vote. For clarity, Vale sees this inclusion as a mechanism to ensure timely completion of approved capital projects, and does not believe this would restrict Aurizon's ability to seek pre-approval again for the project.

Schedules F – I

- Vale supports the QRC's submission and has no further comments on schedules F – I.

Schedule J Coal Loss Mitigation Provisions

- Vale would like to see the inclusion of a positive obligation on Aurizon to provide dust monitoring information from each of its dust monitoring sites on the rail network. Vale believes this is important feedback to customers to monitor its dust levels and promote continuous improvement in the management of coal loss.

For further information regarding this advice please contact myself on (07) 3136 0936.

Yours sincerely,



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Vale Australia Pty Ltd