Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4000

17 April 2015

By email: Aurizon@qca.org.au

Dear Dr Roberts,

WIRP User Submission on QCA Draft Decision – Policy and Pricing Principles

The Wiggins Island Rail Project (**WIRP**) users welcome the opportunity to make a submission to the Queensland Competition Authority (**QCA**) in respect of the QCA's draft decision issued on 30 January 2015 (**Draft Decision**) on Aurizon Network Pty Limited's (**Aurizon Network**) proposed draft access undertaking submitted on 11 August 2014 (**DAU 2014**).

We confirm that the WIRP users comprise Washpool Coal Pty Ltd, Caledon Coal Pty Ltd, Wesfarmers Curragh Pty Ltd, Colton Coal Pty Ltd, Cockatoo Coal Pty Ltd, Yarrabee Coal Company Pty Ltd, Glencore Coal Assets Pty Ltd and Springsure Creek Coal Pty Ltd (**WIRP Users**).

1. Executive summary

While the WIRP Users are generally supportive of the approach taken to the expansion process in the DAU 2014 which, we understand, reflects the outcomes of negotiations between the Queensland Resources Council (**QRC**) and Aurizon Network (**Industry Version**), we have particular concerns as to how the QCA will make pricing decisions in relation to WIRP.

The WIRP Users also have concerns in respect of the expansion tariff put forward in the Draft Decision (**QCA Version**), which appears to include elements which originate from the QCA's own thinking on the subject, rather than the position that was collectively negotiated by the QRC on behalf of the coal industry and Aurizon Network as set out in the Industry Version.

Until recently, the WIRP Users had not considered the possibility that principles in the next approved access undertaking for Aurizon Network (**UT4**) could be applied retrospectively to a project which:

- was commenced and committed to under the rules of the current access undertaking (**UT3**); and
- will be virtually complete by the time UT4 commences.

Based on recent discussions with the QCA and our understanding of the QCA Version, we are now very concerned that this is a possible approach that the QCA may adopt and, as a result, we are very concerned with the implications of such an approach.

This submission:

- addresses the question of what pricing principles should be applied to the WIRP infrastructure; and
- provides the WIRP Users' views on the QCA's proposed expansion pricing principles in its Draft Decision.

As access holders in relation to expansion capacity, the WIRP Users are well placed to comment on these issues. In summary, we note:

Section	Issue
2.1	The UT4 pricing principles are inappropriate for WIRP as they will expose the WIRP Users to the risk of WIRP being treated as a separate system but not provide the WIRP Users with any of the certainty that expansion projects committed to under UT4 will receive.
2.1, 2.4	As it is impossible to restart WIRP under a UT4 process from the beginning, the UT3 pricing principles should be applied to WIRP (and the UT4 decision should require this to occur).
3.1, 3.2, 3.3, 3.4, 3.5	Dividing an expansion on a mainline into an existing system and an expansion system is a step that should only be taken for very compelling reasons because it has adverse consequences such as: • the complexity of tariff pricing increases; • it does not reflect the reality that all trains are using common physical infrastructure, despite notionally using the existing system or the expansion; • the physical utilisation of expansion capacity must remain with the expansion users. This will restrict capacity trading and may trigger unnecessary expansions to the system; • it may encourage competing interests regarding the management and maintenance of each system and will not necessarily result in the best decisions being made by users for the whole consolidated system; • it will result in a capacity management mechanism that is artificial and more complex to administer (to ensure that capacity constraints on one coal system does not infect the users of the other coal system, even though the users are effectively using the same physical assets);
3.6	Separate coal systems should not include any pricing cross subsidisation if there is no risk sharing between the systems. In particular, if the risk of utilisation or capacity shortfall in the expansion system is always borne by the users of that expansion then the existing users should not be cross subsidised merely because tariffs on the expansion are lower than the tariffs on the existing system.
2.2, 3.7	As the commencement of the expansion process is most logically the trigger for applying expansion pricing to access seekers, we would expect all rail access contracted on the Blackwater and Moura systems after the triggering of WIRP receive WIRP system pricing.

2. Pricing principles for WIRP

2.1 Application of UT4

The expansion pricing principles in both the Industry Version and the QCA Version provide processes which involve the allocation of risk between the different interested participants in an expansion process. The principles assume an expansion has had the benefit of the expansion process set out in UT4, so that the application of the pricing principles to the expansion appropriately takes into account that risk allocation.

However, WIRP has now proceeded to the point where much of the infrastructure has been constructed and commissioned, but has not had the benefit of the expansion process in UT4. Accordingly, it is clearly impossible to apply the proposed pricing principles in the manner that is envisaged for future projects.

This makes it impossible to achieve the same balance in the allocation of risk for WIRP as may be achieved for future projects which proceed through the UT4 expansion process. The application of UT4 expansion pricing principles to WIRP will give a hybrid result that does not produce an equitable outcome for WIRP infrastructure when compared to either:

- applying UT3 pricing process to a UT3 expansion (WIRP infrastructure); or
- applying proposed UT4 expansion pricing principles to future expansion projects.

That is, as this submission explains, the application of UT4 expansion pricing principles to WIRP infrastructure will expose the WIRP Users to the risks of the expansion without any of the protections that will benefit future expansion projects.

Since it is impossible to restart WIRP under UT4, we submit that the most appropriate course of action is to continue to apply the UT3 pricing principles to WIRP, and the UT4 decision should require this to occur.

2.2 Capacity determination

The first major protection that new expansion projects will receive under UT4 (whether the Industry Version or the QCA Version) is a transparent process by which the capacity of the existing system is established and the infrastructure required to accommodate the expansion capacity is determined.

This capacity analysis recognises the crucial importance of users being able to ascertain the capacity in the existing system to enable the expansion pricing principles (in both versions of UT4) to operate as intended. Both versions of UT4 contemplate that the expansion infrastructure may be treated as a separate coal system from the existing system. Without a clear understanding of the capacity of the existing system, it is not possible to differentiate the existing and expansion coal systems from each other. The application of this approach produces a coherent result where the expanding users may be contracting for rail capacity in a separate coal system from the existing coal system, but with a clear understanding as to how the two systems are defined before commitment.

By contrast, UT3 does not contemplate that an expansion of an existing system can form a different Individual Coal System. While extensions that did not form part of an existing Individual Coal System (such as the GAPE and NAPE projects) required an amending access undertaking to expand or modify the definition of an Individual Coal System, expansions of existing coal systems under UT3 have not

required an amending access undertaking nor has there been any consideration to whether the capacity arising from those expansions should be treated as a separate Individual Coal System.

UT3 does not require a consideration by the QCA of the creation of a new Individual Coal System for WIRP, but permits Aurizon Network to construct expansions and include them in the RAB provided that the provisions of Schedule A to UT3 are complied with. The only similar analysis (to that proposed in UT4) that occurs is the setting of a reference tariff to the extent that an expansion involves a new loading or unloading point. UT3 does not contain a transparent expansion process under which Aurizon Network must demonstrate the capacity of the existing system and scope the expansion infrastructure required.

As previously noted in correspondence (and confirmed in information) provided by us to the QCA on this subject, the information relating to the capacity of the existing system and the expansion made available by Aurizon Network to the WIRP Users is incomplete and has been subject to material changes throughout the WIRP expansion process. Nor was any definitive determination of the capacity of the existing coal systems ever made by Aurizon Network.

Indeed, subsequent to the WIRP Users agreeing to underwrite an expansion in order to contract for their WIRP capacity, Aurizon Network permitted an additional 5-6 mtpa of capacity to be contracted on the Blackwater system without requiring the relevant access seekers to go through any expansion process.

To apply the UT4 pricing principles to determine whether WIRP should form part of an existing coal system or form a new coal system would be to apply principles which could not have been within the contemplation of Aurizon Network, the QCA or the WIRP Users when negotiating and reviewing the WIRP expansion arrangements. This approach would expose the WIRP Users to the risk of WIRP being treated as a separate coal system without having had any of the benefits associated with this approach and, most particularly, without any of the certainty of the definition of the coal systems that expansion projects under UT4 will have.

We do not consider this outcome is justified.

2.3 Expansion tariffs

As outlined above, there is no concept of an expansion tariff under UT3. The only mechanism which can potentially give rise to a differential tariff for an expansion is the setting of the Reference Tariff for the new Train Services in accordance with Schedule F. The application of this mechanism can, in certain circumstances, give rise to a System Premium which applies to particular Train Services where a Reference Tariff (based on the Incremental Cost of the Rail Infrastructure specific to those Train Services plus a minimal contribution to the Common Costs of the existing system) produces a higher tariff than the System Tariff. The WIRP Users, both individually and collectively, have already made submissions to the QCA on this subject.

Under the Industry Version of UT4, an expansion tariff can arise where the costs of expansion capacity produce a higher tariff for the expansion than the existing system tariff. However, prior to making the decision as to whether to enter into access agreements in relation to expansion capacity, access seekers are aware of whether or not the expansion will be subject to an expansion tariff as a result of and as part of the expansion process. Their decision as to whether to enter into those agreements is therefore an informed decision, which takes into account the likely pricing treatment

that will apply to the capacity which they are contracting for. An informed decision enables the access seeker to undertake an appropriate consideration of the costs and benefits of the expansion, and assists in economically efficient decision making.

By contrast, at the time when the WIRP Users contractually committed to pay for the WIRP expansion capacity, not only were they not informed that an expansion tariff would apply to their access rights, no such concept existed under UT3. Therefore, if the expansion tariff proposal was to be applied retrospectively, the WIRP Users will be exposed to the prospect that the WIRP infrastructure not being socialised into the existing system (and therefore the WIRP Users continue to have a different risk profile to the users of the existing system) without the ability to take that risk into account at the time their investment decision was made.

Under the QCA Version of UT4, expansions would never be socialised within the main system, at least while any UT1 and UT2 access agreements still exist. The WIRP Users disagree with the QCA's approach on this issue (as outlined further below). However, if this position is ultimately reflected in UT4 then the position of the WIRP Users would be even worse if the WIRP pricing decision is made with UT4 pricing principles. The effect of this would be that WIRP infrastructure would never be socialised into the existing system, as a result of a position which was never contemplated by the WIRP Users at the time of their investment decision, and which neither Aurizon Network nor industry (as represented by the QRC) has ever put forward for consideration.

2.4 Regulatory certainty

As highlighted by Aurizon Network in its December 2014 submission to the QCA on WIRP pricing, the

> *…prudency of the investment…should be based on the facts reasonably known to the parties at the time of making the decision to proceed with the investment.*

Aurizon Network further goes on to state that it

> *… conducted detailed financial analysis with respect to the expected regulatory revenue and pricing outcomes. This analysis was conducted with reference to the requirements of the 2010DAU, specifically those outlined in Part 6 and Schedule F.*

Additionally, AN states that it

> *…believes that the pricing principles set out in Part 6 and Schedule F of the 2010AU should be used as the basis for pricing the WIRP Train Services, rather than the principles set out in Part 6 and Schedule F of the 2014DAU.*

Aurizon Network's continued reference to the UT3 principles and framework comes as no surprise to the WIRP Users. This is because negotiation of the WIRP Deed and associated agreements were under the same UT3 pricing and expansionary principles.

However, WIRP Users are concerned that if UT4 pricing principle are applied to the WIRP infrastructure a misalliance in regulatory frameworks could be encountered. Pointedly, at the time of negotiating the WIRP Deed and agreements, parties had no contemplation of potential UT4 expansionary principles, and at the time of signing, the parties had fair and reasonable grounds to believe that prudent WIRP scope would be socialised within the Blackwater system once complete.

WIRP Users note that if alternative pricing principles had been contemplated during negotiations, it would have affected the bargain they were willing to agree with Aurizon Network as it would have affected the risk allocation and profile of the bargain.

Obviously the QCA approval of the WIRP Deed (including the QCA's analysis of the additional risks which Aurizon Network sought to mitigate through the access conditions and how the access conditions mitigated those risks) was in the context of UT3 and UT3 pricing principles. To now impose a new (and, currently, not certain) pricing regime on the WIRP infrastructure gives rise to questions about the adequacy of the initial review by the QCA of the WIRP access conditions.

3. Comments on the QCA Version

3.1 Application of socialisation

The QCA approach to socialisation reflects the "incremental up, socialise down" approach as between expansions on the same coal system. However, because of the QCA's position on the "fixed cost" regime which it wishes to apply to expansion systems, it has concluded that expansion systems should never be socialised with the existing system. It has also expressed the view that the risks of an expansion should be confined to expanding users.

Notwithstanding that under the QCA's decision the users of the existing system are not exposed to any risk arising from the expansion, and that their tariffs will remain set by reference to system forecasts and not on the basis of a "fixed cost" regime, the QCA's draft decision envisages that the expanding users would cross subsidise the existing system if the expansion tariffs were lower than the existing system tariffs. This cross subsidy would occur notwithstanding that the expanding users face a different (and higher) risk profile, to which the users of the existing system are not exposed. It also appears that the cross subsidy applies even where the cause of a tariff differential was the different pricing regime, i.e. the "fixed cost" model, which is applied to expansions.

As noted by the QCA, the existing system is the legacy of the initial State government decision to build the Central Queensland Coal Network, together with all of the expansions to that network which have since occurred. The users of the existing system did not bear all of the risks associated with the development of the existing system. Furthermore, the existing users have not fully funded the development of the existing system – given the assumed amortisation profile of the network, the access charges paid by future users of the network are assumed to be available to contribute towards the recovery of Aurizon Network's capital costs and returns. Existing users are assumed to be replaced by new users as and when the existing users cease to use the existing system. However, both Aurizon Network and industry recognise that for future expansions, the position of the existing users which have funded the development of the existing system to date should not be adversely impacted by an increase in the capacity of the existing system which will occur in order to benefit new users. In relation to new expansions where the expansion process occurs fully under UT4, the WIRP users are supportive of this concept as put forward in the Industry Version.

Both Aurizon Network and industry recognise that there are considerable difficulties which arise as a result of confining expansion infrastructure into separate coal systems. Industry was therefore supportive of the various mechanics within the Industry Version which limited the application of the multi-system model to situations where pricing under a different expansion system produced a material difference in cost or risk to existing users. In the Industry Version, existing users accept

some increase in risk resulting from an expansion and some marginal increase in cost in exchange for certainty that the incremental costs of the expansion are covered by the additional revenue generated by that expansion in order to avoid the creation of new expansion systems.

Additionally, if two coal systems are created, the UT3 approach of 'pooling' of access rights within a coal system, but not across systems would not be able to be applied. There is nothing to suggest that UT4 would not permit pooling; however, the concept relies upon the premise of socialization. Specifically, if WIRP was not socialised within the existing coal systems, WIRP users would be unable to pool access rights amongst other users of those coal systems.

Ultimately, a division into an existing system and expansion systems is a highly artificial one, given that on a mainline expansion all of the trains which are notionally using either the expansion system or the existing system are in fact using common physical infrastructure. This gives rise to considerable practical difficulties. While it is possible to argue theoretical economic benefits of greater and greater granularity in the application of the pricing principles, in reality at some point the practical difficulties become too great in an integrated coal system.

3.2 Complexity

Currently all users of each Individual Coal System are exposed to the costs of the entire Individual Coal System, even those parts of the system which they do not use. The reason that this occurs is that it has been determined that it is both impractical and unnecessary to separate each segment of each Individual Coal System into its own coal system in order to determine which users of the system should bear what costs.

Because of the integrated nature of each system, work which occurs on a segment not used by an individual user of the system can benefit that user because of the effects that work has on the system as a whole.

In a similar way, when it is very difficult to determine what physical infrastructure constitutes the existing system and an expansion, it is equally difficult to determine exactly what capacity arises from what infrastructure – because the infrastructure functions as a whole and not as individual parts. An assessment of capacity of the pre- and post- expansion system is complex and will depend on what assumptions are made for the performance, not only of the existing and expansion rail infrastructure and also for every other element of the system.

It is difficult enough to assess the actual capacity of the network as a whole in the context of the coal supply chain. Having to introduce a further level of complexity with an expansion increases the difficulty of the modelling task. While it is not impossible to reach reasonable judgements that would support a “socialisation” test applying, it is not reasonable to expect a fine degree of precision from what will always be a matter of judgement based on assumptions which will, by their nature, always have a degree of subjectivity.

The establishment and indefinite existence of expansion systems gives rise to considerable difficulties. The access undertaking pricing regime is already a highly complex one as it applies to each coal system. The introduction of expansion systems not only multiplies this complexity by multiplying the number of coal systems which exist, but also by introducing interface issues between different theoretical coal systems which exist across the same physical infrastructure.

While the WIRP Users agree that this is justified in some cases, we note the difficulties created as a factor which would mitigate against the creation and maintenance of a large number of coal systems. These difficulties affect not only users of the expansion coal system but also of the existing coal system.

Therefore we support the proposal made by the coal industry and incorporated into the Industry Version that expansion systems should have a limited lifespan – 10 years was proposed. This sunset date provision will be a mechanism to reduce complexity over time.

3.3 Trading

Trading of rail access is beneficial to the system and to the users of it, because it helps achieve a more efficient allocation of rail capacity to those users which are best able to use it.

However, trading rail access between coal systems is much more difficult than trading rail access within an existing coal system. It is not clear to us how the holder of expansion capacity could trade that capacity to the holder of non-expansion capacity.

One possibility could be that expansion capacity and non-expansion capacity would have to be held under separate access agreements.

On the other hand, that means that if expansion capacity is traded to a different origin and destination pair within the same system then the recipient of the expansion capacity might not actually be a user of the physical expansion assets. This would then create a mismatch between the contracted customers of the expansion system and the actual physical users of the expansion assets.

A logical conclusion of the QCA's view that the risks of an expansion should be confined to expansion users is that the physical utilisation of expansion capacity should remain with the expansion users. If this is correct then trading is restricted, which might produce the result that physical capacity existing within the system could not be traded to an access seeker, hence triggering an unnecessary physical expansion to the system.

We do not believe that this conundrum can be solved by making the access rights transferred subject to the physical capacity of the expansion assets – because if those assets are not actually physically used by the transferee then the perverse outcome of this structure would be to prohibit the transferee from using physical capacity which actually exists because of constraints which exist elsewhere on the coal system and do not affect that user. Again, if pursued to its logical conclusion this would lead to a requirement to create unnecessary additional physical capacity on the coal system to preserve a theoretical distinction between the existing and expansion systems.

3.4 Decision making

The users of a coal system are expected to be involved in decisions which relate to that coal system. Presumably, under the QCA Version the users of the expansion infrastructure would be excluded from decisions which relate to the existing system and vice versa. However, the two sets of users will be affected both operationally and financially by decisions taken in relation to the other system.

The operational effects are clear – given that all trains use the same physical infrastructure, operational decisions in relation to the existing system (which may constitute a substantial

proportion of the physical infrastructure used by expansion users) will have impacts on the expansion users.

Expansion users will be financially affected because of the QCA's proposition that the expansion users should cross subsidise the existing users through the imposition of a common cost tariff. The users of the existing system will not necessarily have interests which are aligned to the interests of the expansion users. For example, if usage of the system by the holders of non-expansion capacity falls then the holders of that capacity will have little incentive to invest in maintenance of the capacity of the existing coal system. Given that the users of the expansion system are likely to be new or expanding mines whereas users of the existing system are likely to be existing mines, then different priorities may well exist between these different groups.

3.5 Capacity risk

It appears impossible to segregate the risks associated with the levels of performance delivered by Aurizon Network as between users of the existing system and the expansion system on an ongoing basis. Once it has been verified that the expansion system has indeed delivered the expected levels of capacity, we would assume that the users of the existing system and the expansion system would be exposed to the same levels of performance risk of the integrated physical coal system.

Given that all users use the same physical assets, the only way to achieve a differential exposure to risk in different assets would be to have a different priority allocation of the impacts of physical capacity shortfalls depending on the root cause of the capacity shortfall – e.g. a problem with or the closure of existing assets would result in the capacity shortfall being deemed to affect users of the existing system first, while a problem on a duplication might be deemed to affect expansion users first.

We would not expect such a mechanism to be pursued given that it would be highly artificial and complex to administer. Since the physical risks to capacity effectively must be socialised between all users of the same coal system, we submit that this suggests that socialisation of the commercial structure should also occur so as to align it with the physical risks which actually arise within a coal system.

3.6 Cross subsidy

We do not agree with the QCA's proposed imposition of a cross subsidy from an expansion system to the existing system. In the QCA Version, the two systems would have tariffs set on the basis of different take or pay methodology producing the perverse outcome that there could be a cross subsidy which arises merely because the existing system tariffs are set on the basis of a forecast tonnage and hence the per tonne rate is higher than in the expansion system where the tariff is based on contracted tonnages under the "fixed cost" regime.

The QCA analysis of the principles proposed to be applied by Aurizon Network states that existing users should not be exposed to risks associated with volume risk on an expansion system. If that is the case, why should expanding users be exposed to volume risk on the existing system? A cross subsidy which can arise due to a shortfall of forecast volume on the existing system would expose expanding users to this risk.

Furthermore, basic principles of economics and equity generally assume that those parties who bear the risk of an adverse outcome should be entitled to the benefit of a positive outcome. The QCA's opinion is that the risk of a tonnage shortfall in the expansion system should always be borne by the users of that expansion. If the usage risks of the expansion are confined to the users of that expansion, it is unclear to us why the users of the existing system should receive any benefit of lower tariffs merely because tariffs on the expansion are lower than the tariffs on the existing system when the existing users are not exposed to any risk arising from tonnage shortfalls on the expansion system.

The QCA's draft decision states that the objective of the cross subsidisation mechanism is to align the expansion tariff with the system reference tariff on a $/NT basis, but it is not clear to us why the QCA is seeking to align the price of existing and expansion tariffs when both the basis on which the tariffs are set and the risk profile to which users in each system are exposed are different. The QCA's decision in this regard seems unfairly slanted to benefit users of the existing system at the cost of expansion users. In fact the effect of the decision is that only the benefits of the expansion are socialised but the risks are borne by the expansion users alone.

The QCA draft decision states that the reason that the existing users should receive this cross subsidisation benefit is to reflect the benefits that the expansion users receive from infrastructure which was underwritten by previous users. We consider that this is an insufficient reason for a cross subsidy to be imposed on new users for the benefit of existing users, if there is no socialisation of the pricing system or risk across the new and old users.

We note that the new users may be forced to pay away to incumbent users a pricing benefit which may only be transitory in nature. The existing users are not disadvantaged in any way by the expansion of the system capacity, given that under either version of UT4 sufficient expansion capacity is required in order to service the expansion users and it is the expansion users which will have their capacity reduced in the event of a shortfall. In fact, existing users are likely to gain through non-capacity impacts such as increases in resilience and availability.

3.7 Post-expansion access seekers

The QCA's view is that post expansion access seekers should pay the expansion tariff. We agree with this principle. We also assume that it would mean that the capacity held by expansion users could not be resumed by Aurizon Network under the "use it or lose it" provisions unless the new user of the capacity was prepared to pay the expansion tariff for that infrastructure.

However, we believe that there are practical difficulties which arise from the fact that the expansion assets co-exist within the same physical coal system as the existing system. In order to ensure that the existing users do not effectively become users of the expansion infrastructure by "stealth", the capacity of the existing system must be kept under constant review to ensure that it remains sufficient to deliver the non-expansion tonnages. If the non-expansion infrastructure capacity becomes insufficient over time then, to the extent of any excess of non-expansion usage, that excess should be treated in the same way as a party which has subsequently contracted for access to expansion infrastructure.

Furthermore, where there is a separate expansion system, existing system users should not be allowed to access expansion capacity as to do so would negatively impact upon any expansion capacity user.

The same issue also applies as between different expansion systems. We understand that the requirement to monitor this capacity issue might be very difficult, but to the extent that expansion systems are created, they should be protected from having their capacity transferred to the existing system in the same way that the users of the existing system should be protected from having their access rights eroded by expansion users.

We would not understand a decision which provided this protection to users of the existing system but not to expansion users.

However, the complexity of monitoring these issues is another reason to resist the creation of separate expansion systems except where there is a compelling reason to do so. If an appropriate sunset date for the expansion system is introduced, the requirement for this kind of monitoring may be reduced.

It is not clear from the QCA Version exactly when this principle would be applied to new access being contracted on the network. In order to address the QCA's concern that free-riding on an expansion should be prevented, once Aurizon Network has required users to begin an expansion process in respect of a coal system because of a lack of new capacity, it should apply to all contracts for capacity that are entered into after that decision by Aurizon Network.

Under the UT4 principles, we assume that the commencement of the expansion process would be the trigger for this principle to apply to all new contracts in the relevant coal system. If WIRP pricing is determined under UT4 pricing principles, we assume that the QCA would apply UT4 pricing principles to all rail access contracted on the Blackwater and Moura systems after the triggering of WIRP to WIRP system pricing. However, in this regard, we understand that 5-6 mpta of access has been contracted on the Blackwater system since the WIRP process began.

If the QCA is unable to apply WIRP pricing to those tonnages, then this is another illustration that the application of UT4 principles to WIRP on a partial basis produces an unfairly unbalanced result for WIRP users compared to the application of the UT4 principles to a new expansion project that is developed under UT4 from the beginning.

3.8 "Fixed cost" tariffs

While the WIRP users agree that a "fixed cost" regime is, in principle, a preferable basis for the setting of tariffs to the existing forecast tonnage basis, we do not consider that the benefits of the "fixed cost" regime are sufficiently great that expansions should be quarantined from the existing system purely to allow a "fixed cost" price regime to be applied to expansion capacity.

For the reasons outlined above, a single integrated system is the preferred outcome except where incremental pricing produces a material difference in cost or risk allocation between systems. Although we understand the benefits of the "fixed cost" regime, we do not consider that these benefits are sufficiently great to justify the imposition of a separate expansion tariff where this would not be justified on other grounds.

On that basis, where any decision is being made as to whether an expansion should be integrated into an existing coal system (either initially or as part of any subsequent reassessment), we suggest that this assessment should be carried out on the basis of applying the same tariff calculation

methodology to the expansion as applies in relation to the existing system, including on the basis of the application of the same take or pay methodology. Of course, if the decision is taken to integrate the expansion into the existing system at any point, then the same take or pay methodology must apply to the expansion as the existing system.

However, while an expansion is incrementally priced, we agree that the calculation of the tariffs for the expansion should be calculated on the basis of the "fixed cost" regime.

3.9 Benefits to existing users

We understand why the QCA has stated that the onus of proving the benefits of an expansion for existing users should lie with Aurizon Network and new users, due to the difficulty for existing users in being able to ascertain whether this is the case.

However, there are similar difficulties for expansion users in being able to demonstrate the benefits of expansion capacity. The expanding users (particularly in the case of WIRP, but also more generally) are unlikely to be in possession of the detailed engineering and network capacity modelling and expertise that would be required to demonstrate the benefits for existing users. The party which is in possession of the required information and expertise is Aurizon Network.

The problem is that Aurizon Network may have incentives to minimise the extent of the benefit conferred on the existing network. For example, a confirmation that an expansion benefits the existing network may be construed as an admission of the insufficiency of the existing network which is commercially or legally unhelpful for Aurizon Network.

We suggest that the QCA consider mechanisms to ensure that the degree of benefit is established and independently verified early in the expansion process, and that both existing and expanding users have some involvement in this process.

3.10 Process

We note that the QCA proposes that a draft amending access undertaking should be submitted for each expansion for the approval of a new or varied reference tariff. We do not consider that a variation of the access undertaking should be required in every case.

Given that UT4 will set out the rules under which the decision should be made, we consider that the decision should be made in accordance with that undertaking rather than as a variation to it. We cannot see any reason why an amendment to the undertaking should be preferred.

If you have any questions relating to the information attached or our submission, please contact our representative Jamie Freeman (jfreeman@balanceadvisory.com).

Yours sincerely

WIRP Users[1]

[1] Washpool Coal Pty Ltd, Caledon Coal Pty Ltd, Wesfarmers Curragh Pty Ltd, Colton Coal Pty Ltd, Cockatoo Coal Pty Ltd, Yarrabee Coal Company Pty Ltd, Glencore Coal Assets Pty Ltd and Springsure Creek Coal Pty Ltd