Required Adjustment to the Access Undertaking in the Context of the Wiggins Island Rail Project Deed

Report to Glencore

July 2016

Acronyms and Abbreviations

RAB	Regulatory Asset Base
MAR	Maximum Allowed Revenue
WACC	Weighted Average Cost of Capital
AU	Access Undertaking
WIRP	Wiggins Island Rail Project
WICET	Wiggins Island Coal Export Terminal

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Executive Summary

The Queensland Competition Authority (the QCA) is the access regulator for the Queensland rail networks. Its role as the regulator is to get the right balance of risks and rewards between the access providers and access seekers so as to achieve the objectives set out in the Queensland Competition Authority Act 1997 (Qld) (the QCA Act). Section 69E, Part 5 of the QCA Act specifies the objective of ensuring the operation, use and investment in the networks with the effect of promoting competition in upstream and downstream markets). Our analysis shows that to achieve this objective, the QCA needs to ensure such balance ***at all times and in total.*** That is, the QCA needs periodically to take into account the overall balance of risks and rewards available to the operator of the rail network from the combination of the Access Undertaking and the Access Conditions.

Where providing the required access requires the access provider to invest in new capacity, as in the case of the Wiggin Island Rail Project (the WIRP), the QCA's task is difficult as the access regime does not create any legally binding obligation to invest. Hence, any specific access provider, and networks generally, have considerable market power with respect to new investment.

There are **three** possible instruments available to the QCA to ensure that new investments do not result in an inefficient misuse of this market power:

- Through detailed up-front analysis of Access Conditions. Access Conditions serve not to incentivise the access provider to invest, but to compensate it for any additional costs and risks of investment. To ensure the right balance a careful review of additional risks and additional rewards is required
- Through on-going periodic review of the totality of risks facing the network and the totality of rewards available under both the Access Conditions and the Access Undertaking and
- Through a well-elaborated user funding mechanism which gives users a practical ability to invest at reasonable cost in the event of hold-out by the network in the negotiation of Access Conditions.

In 2010 when the Access Conditions for the WIRP (the WIRP Deed) were negotiated with the users, there was no effective user funding mechanisms in place to provide the users with countervailing power. At the time, the QCA also formed the view that it was not required to provide close oversight because the parties to the WIRP Deed had agreed to its terms. This conclusion was reached on the basis of the criteria for approval which the QCA set in 2009.

Since then, as a general observation, the QCA has highlighted that users' agreement to Access Conditions in order to secure the necessary investment cannot be taken as evidence that there was no misuse of market power, since users had no other realistic choice. This general observation has very specific application to the on-going payment of fees set under the WIRP Deed.

To fulfil its legislative obligations, the QCA needs to continue reviewing whether the balance of risks and rewards is right taking into account both the WIRP Deed and Access Undertakings and make adjustments in future Access Undertakings to prevent over compensation to the access provider.

The QCA has already highlighted in a number of ways that this continuous monitoring, review and assessment of the balance of risks and rewards is necessary:

- In setting the framework for Access Conditions in 2009, it required a mechanism to ensure that if at any time costs and risks were compensated both in the Access Undertaking and Access Conditions, users should receive an appropriate rebate of their normal Access Charges so that there was no double counting
- In its approval of the WIRP Deed in 2010, the QCA acknowledged that there might be disadvantage to non WIRP users in the future but that this could be addressed through *"existing provisions in the undertaking and through the Authority's monitoring of how the WICET arrangements are implemented in practice"*[1]; and.
- Various comments in its approval of UT4 on the difficulties of separating the WIRP costs and risks from non-WIRP costs and risks and the impacts and interactions of the two notionally separate processes.

This separation issue manifests itself in much of the UT4 determination and it is clear that even if they were initially separable:

- The WIRP and non-WIRP users and services have mixed. As an example, users with train paths contracted under both WIRP and non-WIRP conditions can arbitrage volume decreases and increases between the two sets of contractual conditions to their advantage
- Costs and risks merge, as all users use the combined network and it provides resilience and reliability benefits to both WIRP and non-WIRP users. This is reflected in the socialisation of some WIRP costs across all users; and
- The WIRP physical infrastructure is highly integrated with the rest of the Central Queensland Coal Network CQCN and is operated and maintained as a single network. This means, for example a delay on the network for some failure of the infrastructure cannot be meaningfully attributed to the WIRP or the remainder of the network.

Further in UT4, and in the future, the Investment Framework has evolved from that in place at the time of the WIRP Deed. The framework is arguably now more rigorous and places additional restraints on Aurizon that were not present at the time of the Deed.

This means that without consideration of the effects of the WIRP Fee, the WACC set by the QCA in UT4 and subsequent Access Undertakings will be estimated on the basis of providing compensation for the costs and risks of the Access Undertaking Investment Framework at the time. So, to the extent that the potentially greater costs and risks created under previous, less rigorous, frameworks are mitigated or compensated by the WIRP Fee, there is likely to be a mismatch of risks and rewards.

In the absence of the on-going matching of the totality of risks and rewards under the Access Undertaking and the Access Conditions, there is a high probability of inefficient extraction of monopoly rents.

While QCA cannot repudiate its approval of the WIRP Deed, it needs to ensure that the totality of the balance of costs and risk—that is Access Undertakings plus the WIRP Deed— remains appropriate.

To achieve the objectives set for it in the legislation, QCA has the ability to adjust the WACC in Access Undertakings to take account of the effect of WIRP Fee on the overall

[1] QCA, *Final Decision Wiggins Island Rail Project Stage 1 Rail Infrastructure Access Conditions,* May 2012, page 11, 3rd last para

risks and rewards that the access provider gets from the Access Undertaking and WIRP Fee combined. Our analysis shows that such an adjustment is necessary.

Such an adjustment will continue to provide investment certainty for the access provider. To the extent that additional risks remain, an additional fee may still be appropriate. That is, the analysis should not be done with hindsight of past risks, but should look forward at risks that are now subsumed into the Access Undertaking.

1 Introduction

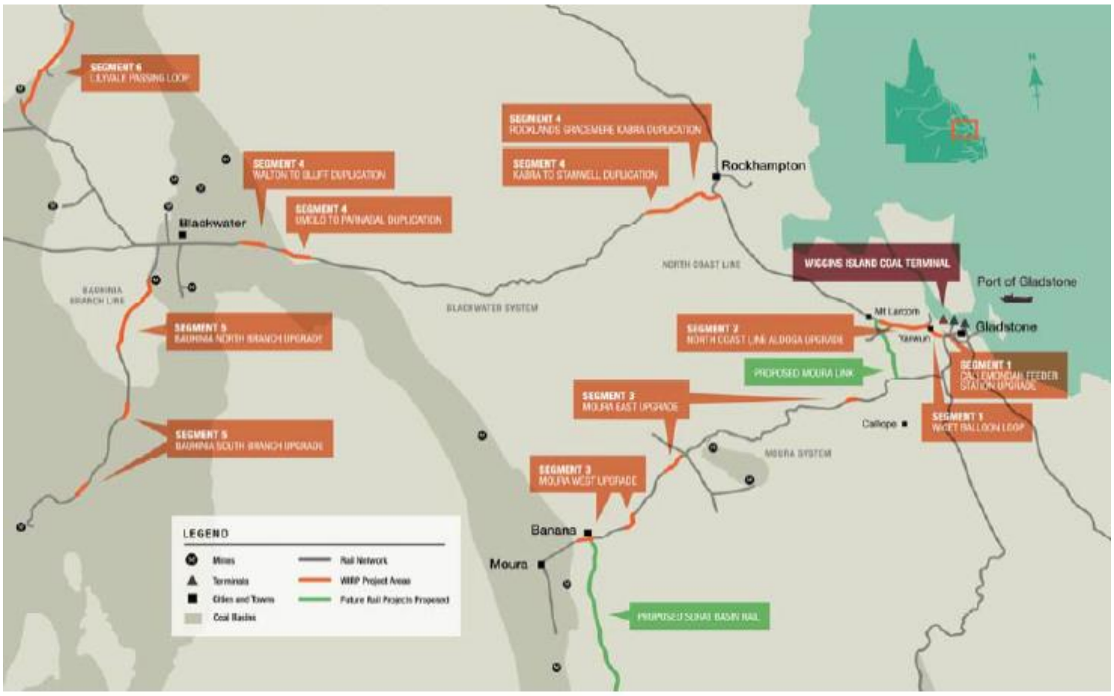
In this report we consider the effect of the Wiggins Island Rail Project (WIRP) Deed on the on-going regulation of the access provider by the Queensland Competition Authority (QCA).

The Deed was negotiated between the access provider and WIRP users to expand the Central Queensland Coal Network (CQCN) to provide the additional capacity needed to support the Wiggins Island Coal Export Terminal (WICET).

WICET's first stage is intended to provide additional coal export capacity through the Port of Gladstone of 27 million tonnes to a consortium of eight coal exporters (the WIRP users).

In conjunction with the development of the coal terminal, the WIRP consists of significant upgrades and expansion of the Moura and Blackwater coal systems. WIRP is divided into six project segments and includes a new balloon loop and track duplications and upgrades as shown in Figure 1.1.

Figure 1.1: Wiggins Island Rail Project



Source: Aurizon publication

The WIRP Deed was negotiated by the WIRP users and approved by the QCA as the Access Conditions as a consequence of an agreement to proceed with the required investment. Access Conditions (as defined in the Access Undertaking) are additional terms that may be negotiated in order to compensate the access provider for any costs and risks of the project that are over and above those that are compensated through the regulated returns obtained by the access provider from its QCA approved Access Undertaking.

The Access Regime under the Queensland Competition Authority Act 1997 (Qld) (the QCA Act) requires the QCA to balance the interests of users and investors in monopoly infrastructure. The objective of regulation is to ensure that investors are appropriately compensated for the risks and costs they incur, while protecting users from the exercise of monopoly power.

To achieve the appropriate balance, regulation needs to balance all the relevant risks and rewards. The access regime envisages two related frameworks for the consideration of costs, risks and returns: Access Undertaking and the Access Conditions. In this report we consider how these frameworks should relate to each other in order to achieve the overall objectives of the Act.

Our analysis in this report shows that it would be counter to the objectives of the Act and to the principles of good regulatory practice to limit the consideration of the Access Conditions to a single one-off review at the time of the initial approval. Rather, the Access Conditions (formulated through the WIRP Deed) will have a continuing effect on Aurizon's overall risks and returns. Unless that effect is taken into account by the QCA in its approval of future Access Undertakings, Aurizon will likely be over-compensated for the risks it faces.

In this report:

- Section 2 describes the Access Regime and its objectives, including the objective of ensuring efficient investment and the mechanisms available to achieve that objective in the absence of a binding obligation for the access provider to invest in new capacity such as the WIRP
- Section 3 analyses the QCA's approval of the WIRP Deed
- Section 4 explains why the QCA should on the on-going basis take the WIRP Deed into account when considering the appropriate balance of interests under the Access Undertakings
- In Section 5 we outline a proposed process for the QCA's continued consideration of the WIRP Deed.

2 The Queensland Rail Access Regime

The rail networks in Queensland provide services that are declared under the QCA Act. The Queensland rail Access Regime has been certified by the National Competition Council as effective.

The role of the QCA in regulating access to these rail networks is, like all economic regulators, to balance the interests of owners of monopoly infrastructure and the users with the aim of enhancing economic efficiency. In general, best-practice economic regulation envisages that efficiency will be maximised if investors are sufficiently compensated for the risks and costs of providing the service, so that they have adequate incentive to invest, while protecting users from the effects of monopoly or near monopoly.

While the need to achieve an efficient balance is not controversial, it is more difficult to articulate a process that would bring risks and rewards into a continuous balance. The Queensland Access Regime specifies two processes: an analysis involved in the regular reviews of the Access Undertakings and an analysis involved in the approval of the Access Conditions relating to new investment. The intention is that the Access Conditions would provide compensation for the additional risks and costs associated with new investment that cannot be covered by the Access Undertakings, which are focused on the return on and of sunk capital (including maintenance CAPEX) as well as the recovery of OPEX.

There are two possible ways in which these processes could interact. One approach would be to consider the approval of Access Conditions as a one-off exercise: an analysis that must be undertaken at the time when new investment is needed, but which does not need to be brought into the regulatory framework on the on-going basis. On this logic, periodic reviews of the Access Undertakings would provide on-going balancing of the risks and rewards for on-going operations in a way that is not related to the investment risks.

An alternative approach is to require all risks and rewards—both relating to the new investment and to on-going operations—to be balanced continuously. On this logic, the risks and rewards covered by the Access Undertakings and the risks and rewards covered by the Access Conditions should jointly provide an efficient balancing between the interests of the access seekers and access providers at all times. Since Access Conditions may be approved for a long period of tim[redacted] periodic reviews of the Access Undertakings provide the vehicle for dealing with the overall balance.

In order to evaluate these two possible approaches, we start by describing the key aspects of the Queensland regulatory framework and consider how they fit together.

2.1 Rail access regulation objective—efficient investment

The QCA Act in Part 5 (Section 69E) in setting the objective of the QCA and the regulatory framework expresses this as:

> *The object of this part is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets.*

As with all of the State and Commonwealth access regimes, this objective derives from Clause 6 (f) (1) of the Competition Principles Agreement (CPA) and is key to ensuring that the regime is effective—that is meets all of the principles of Clause 6 of the CPA.

Economically efficient investment in infrastructure is generally considered to occur when:

- Users of the service pay only the efficient cost of the infrastructure used to provide that service—that is there are no monopoly rents extracted by the infrastructure owners; and
- Investors in the infrastructure receive appropriate compensation for the risks and costs of their investment—that is there is no incentive to over or under invest in infrastructure.

In general, when we consider access regimes that impose an obligation to invest, there is no doubt that regulators are expected to balance risks and rewards between investors and users—***at all times and in total.*** For example, in the access regime in place for the electricity sector—as implemented by the AER—electricity utilities are required to undertake appropriate investment to meet the needs of the consumers. The risks associated with new investments may change from time to time. Periodic regulatory reviews undertaken by the AER take into account all relevant information available at the time to achieve an appropriate balance for the period. Clearly for such networks where there are millions of "access seekers", the "common carrier with investment obligations" approach is the only feasible approach.

In the case of rail regulation by QCA, the absence of compulsion over investment complicates matters. On the face of it, the absence of compulsion creates a number of parallel processes:

- Periodic reviews of the Investment Framework embedded in the Access Undertakings
- Occasional approval of the Access Conditions
- Review of other terms of the Access Undertakings (such as WACC).

We argue that each of these individual functions are part of an integrated whole and cannot be subdivided. Despite the apparent separation of these processes, QCA analysis of the balance of risks evolves over time both as circumstances change and more information comes to hand. This evaluation does not mean that regulation is retrospective as past decisions are not overturned, but that in making current decisions, the regulator, while having regard to past precedents makes those decisions according to the current circumstances and information.

2.2 Obligation to Invest

The Queensland rail access regime, in common with various access regimes in Australia, does not impose a clear and enforceable obligation for the access provider to invest to expand or extend the network to meet the needs of access seekers.

This is because all of the regimes are based upon and largely mirror Clause 6 (10) of the CPA that states:

> *The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:*
>
> *1. such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;*
>
> *2. the owner's legitimate business interests in the facility being protected; and*
>
> *3. the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.*

The equivalent section of the QCA Act (Section 119(4)(c)) states that *"…the authority may make an access*

determination requiring an access provider to extend, or permit the extension of, a facility if…"[2] provided that the QCA is satisfied that the following conditions are met:

> *(i) the extension will be technically and economically*
>
> *feasible and consistent with the safe and reliable operation of the facility; and*
>
> *(ii) the legitimate business interests of the owner of the facility are protected*
>
> and further (Section 119(5)):
>
> *the authority imposes a requirement under the determination on a person other than the access provider to pay the costs of extending the facility*

Neither Clause 6 nor the QCA Act impose any absolute investment obligation on access owners. This lack of investment obligation came about because the basis of the Clause 6 framework was designed for access to the monopoly component of existing vertically integrated infrastructure for a small number of access seekers.

However, since the CPA in 1995, almost all of the formerly vertically integrated infrastructure entities in the electricity, gas, telecommunications and other sectors have become vertically unbundled infrastructure only service providers. In contrast to vertically integrated monopolists, infrastructure only firms have no incentive to deny access for anti-competitive purposes. Such firms are incentivised to invest in order to expand access, but equally have an incentive to extract monopoly rents. Where possible, infrastructure only firms may be expected to hold out on new investment in order to extract monopoly rents. In general, where demand for infrastructure is not sensitive to prices (that is, users would rather pay monopoly rents than not have the services they need), hold-out by investors would lead to the extraction of monopoly rents.

The key challenge remains the lack of countervailing power of users to negotiate with the rail network owner. For this reason, the various access undertaking regimes including the Queensland rail access regime, are required to have an approved "Investment Framework" setting out the terms and conditions under which the access owner will expand or extend the network.

2.3 Access Conditions

As part of the Investment Framework in the 2009 Approved Access Undertaking (UT3), the QCA approved the imposition of "Access Conditions". These are conditions that are reasonably required to mitigate the access provider's exposure to the financial risks of providing access where such access cannot be provided without significant investment. In this context, "significant" was greater than the $300 million per project that the access provider voluntarily committed to finance without conditions in the approved UT3.

The Access Conditions in UT3 require that the access provider defines and details the additional risks and costs that it would face through providing access via an expansion of the network—that is costs and risk that would not be compensated by the WACC approved in the Access Undertaking or included in the approved operating costs. It also requires the access provider to demonstrate:

[2] from QCA Act, Clause 119 (4)

- To the extent Access Conditions involve adjustment to cash flows, that these aren't mitigated by other aspects of the conditions and that they are reflective of possible outcomes and their probability of occurrence
- To the extent the Access Conditions involve a varied WACC, that it would have a materially different credit rating or gearing to that of the regulated WACC as a result of the investment in the expansion; and
- The additional costs and risks could not be mitigated by long term take or pay Access Agreements or through insurance or other financial instruments.

Importantly, UT3 states that where the access provider "earns revenue from the Access Seeker's Access that is additional to the ongoing Access Charge", then it must provide a rebate or equivalent to the extent that a cost component in the ongoing Access Charge is separately funded through the additional revenue from the Access Conditions (Clause 6.5.2 (d)).

This is a key concept—that there is no double counting of the costs and risks; and that if such a situation arises at any time then the additional revenue must be rebated.

UT3 also requires that Access Conditions must be approved by the QCA and specifies the criteria for approval. In Section 0 we discuss the QCA's approval of the WIRP Deed Access Conditions.

2.4 The Investment Framework

The Investment Framework under the Access Undertaking has evolved over time. In this section we detail the frameworks in UT3 and UT4.

2.4.1 UT3 Investment Framework

At the time the WIRP Deed was negotiated, under the UT3 Investment Framework, the framework was not well developed and offered little countervailing power to access seekers. Under the UT3 Investment Framework, in response to requests for increased capacity from users, the access provider had three choices:

- It could **voluntarily accept** the obligation to finance investment in additional capacity and would thus recover its investment through the normal Access Undertaking charges. UT3 contained a commitment by the access provider to finance expansion projects up to the value of $300 million
- It could **negotiate "Access Conditions"** with the users that have requested additional capacity. These are conditions and charges in addition to those of the Access Undertaking. Under UT3 (and the QCA Act), the QCA must approve any such Access Conditions; or
- It could **refuse to finance** the extension, but in that case, it must allow the users requesting the capacity to fund the expansion—the user funding option.

However, the overall framework under UT3 was weak, with users having little countervailing power in negotiating Access Conditions as the option of user funding was not elaborated in sufficient detail, and thus not available in a practical sense. While the Access Undertaking provided for a possibility of user funding, the absence of well-developed documentation and detailed guidance on how the access seekers could take advantage of this option meant that further complex negotiations and significant delays would have been needed for the user funding mechanism to become an effective substitute for the Access Conditions. In turn, the absence of an effective substitute meant that the Access Conditions could be imposed even if they included the exercise of market power.

The QCA has acknowledged this weakness, stating, in regard to expansion that had taken place during UT3, including the WIRP:

> *This has taken place without there being a formal process for developing and assessing the costs and benefits of CQCN expansions.*
>
> *Stakeholders raised concerns that Aurizon Network has been able to control information flows, restrict access to expansion studies and dictate the scope and outcome of any studies sought. Stakeholders considered this has resulted in unnecessary delays in progressing investment studies of coal mine and terminal projects. Many stakeholders said, in the absence of regulatory discipline around stage-gating CQCN investment projects and user funding arrangements, they were left no choice in UT3 but to accept access conditions imposed by Aurizon Network to avoid unnecessary delays.*[3]

2.4.2 UT4 Investment Framework

The QCA addressed some of the weakness of UT3 in the revised investment framework set out in their approval of UT4. It sets out a more rigorous process around stage gating with timelines for the access provider, as well as a substantially more developed user funding arrangement It also considered the question of the access provider's *"legitimate business interests"*[4].

UT4 Stage Gating

For the stage gating process in the UT4 Investment Framework QCA specifies that:

- The access provider is subject to a timeframe within which it must advise whether it is willing to fund expansions at the regulated return
- Negotiations undertaken include all stakeholders to provide full transparency and accountability on the terms, conditions and capacity impacts of the expansion proposals
- Standardised contracting frameworks in a form acceptable to funding parties underpin the expansion
- Adoption of appropriate investigation and study processes underpin the expansion
- Approval and governance processes align with those adopted by access seekers and prospective third party financiers when taking investment proposals to their Boards; and
- effective, simple and transparent dispute resolution mechanisms are available.

Overall, in contrast to UT3, under the UT4 framework the QCA has a much greater and more hands-on role in the negotiation of both expansions and Access Conditions through setting enforceable timelines and information provision requirements for the access provider, and acting as an arbitrator in resolving disputes during the process.

UT4 User Funding Agreement

The Investment Framework approved by the QCA for the 2014 Draft Access Undertaking (DAU) included a Standard User Funding Agreement (SUFA) suite of agreements and documents that had the objective of providing a workable, bankable, tax effective and

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[3] QCA, *Final decision Aurizon Network 2014 draft access undertaking Volume II—Capacity and expansions*, April 2016, page 159, 160

[4] QCA, *Final decision Aurizon Network 2014 draft access undertaking Volume I—Governance & access*, April 2016, Section 2.3.2

credible alternative for financing an expansion compared to the access provider financing the expansion.

However, it is an untried and untested process with high transaction costs. The development of the eight related *pro forma* agreements took several years and runs to over 600 pages of complex legal documentation.

Legitimate business interests

In the UT4 DAU, the access provider proposed that its legitimate business interests should be accorded fundamental weight in respect of the expansion process. They proposed that the QCA could not balance its's legitimate business interests against the interests of access seekers users—that is, the access providers' interests had primacy.

QCA rejected this approach in its final decision on UT4 stating:

> *Aurizon Network's legitimate business interests were appropriately satisfied through the provision of the regulated rate of return and any relevant incremental operating and maintenance costs when it chooses to invest*[5]

This is an important decision. While it does not constitute an obligation to invest, it does highlight that Access Conditions when imposed must be clearly linked to ***additional*** costs and risks and that the ***normal*** costs and risks of investment in new capacity are compensated by the standard Access Charges.

2.5 Summary

In summary, the Queensland regime for regulating rail networks recognises that new investment poses significant risks of use of monopoly power. The tools for preventing such use have been evolving over time. Under UT3, the QCA relied more on the Access Conditions and the (voluntarily accepted) obligation to invest up to $300 million per project. Under UT4, the obligation to invest is removed, but this has been offset by considerable strengthening of the user finance mechanism. The review of the Access Conditions remains an important instrument.

This evolution suggests that QCA recognises that a satisfactory balance has not yet been struck. In particular, it is clear that the approval of the Access Conditions is not a stand-alone process apart from the rest of the Investment Framework. Rather, the Access Conditions need to be seen as part of the integrated framework. We discuss this next.

[5] QCA, *Final decision Aurizon Network 2014 draft access undertaking Volume II—Capacity and expansions*, April 2016, page 170, 2nd dot point

3 QCA's Approval of Access Conditions

The QCA's approval of Access Conditions has to be seen within the context of the overall tools available to the QCA to control misuse of the access provider's monopoly position arising from the ability to hold out on an investment that is required to provide capacity sought by access seekers.

In the overall task of providing an appropriate balance between owners and users, the QCA has three key tools available:

- The first is a detailed up-front analysis of Access Conditions as part of its approval process, including a careful review of additional costs and risks and additional rewards to ensure the right balance
- The second is the existence of a well-elaborated user funding mechanism which gives users a practical ability to invest at reasonable cost in the event of hold-out by the network. Such a mechanism would give the QCA confidence that the access provider faced competitive pressure in its negotiation of Access Conditions; and
- The third is the on-going review of the totality of risks facing the network and the totality of rewards available under both the Access Conditions and the Access Undertaking as part of each Access Undertaking approval.

As we show below, the approval of the current Access Conditions occurred at the time when there was no viable self-funding alternative, and yet the approval process was relatively light-handed and relied on the WIRP users' agreement to the WIRP Deed as the primary evidence of the Deed not being anti-competitive. At the same time, the QCA recognises that in negotiating Access Conditions, users have little countervailing power as they are negotiating with a monopoly that can, at its discretion, refuse to fund a project or demand an unreasonable payment. This apparent contradiction suggests that approval of Access Conditions cannot be relied on as the only tool to ensure the right balance between access providers and access seekers. In fact, the very fact that the approval was relatively light-handed creates the need for the QCA to use other tools available to it, and in particular to undertake on-going review.

3.1 QCA Approval of the WIRP Deed

Given the that in UT3, the option of user funding was not practically available (and is arguably still untested in UT4), the agreement of all users to Access Conditions should not be given a great deal of weight by the QCA in its approval considerations. This now also appears to be the QCA's view.

However, the approval criteria set out in UT3 did not recognise the risk of the Access Conditions being imposed in the absence of practical alternatives. In fact, in UT3 the approval criteria were weaker if all users agreed to the conditions. In that case, the QCA only needed to consider:

- The public interest including in having competition in the market; and
- That the Access Conditions will not disadvantage users that are not a party to the negotiated conditions.

By contrast, if some or none of the users agreed to the conditions, the QCA would have had to consider additional criteria:

- If the Access Conditions were reasonably necessary to compensate for the additional costs and risks

- If those additional costs and risks could not be mitigated by long-term take-or-pay Access Agreements
- To the extent Access Conditions involve adjustment to cash flows, that these aren't mitigated by other aspects of the conditions and that they are reflective of possible outcomes and their probability of occurrence; and
- To the extent the Access Conditions involve a varied WACC, that it would have a materially different credit rating or gearing to that of the regulated WACC as a result of the investment in the expansion.
- The additional costs and risks could not be mitigated by long term take or pay Access Agreements or through insurance or other financial instruments.

This weight placed on user agreement as part of the approval process meant that the QCA scrutiny of the WIRP Deed was is weak and provided little countervailing power to that of a monopoly access provider. Coupled with the lack of an effective user funding option, it is likely that users had little choice but to agree to the conditions to gain access in a timely manner.

The QCA in its approval of the WIRP Deed in 2010 determined that the WIRP Fee:

- Was not contrary to the public interest, although it noted that as it was not required to assess if the costs of transporting coal were above efficient costs as a result of the Deed. A key factor in its determination was the desire of the WIRP users to see the project proceed and
- Would not reasonably be expected to disadvantage non—WIRP Deed users. However, it noted:

> *Given this, the Authority accepts that it is possible that the access conditions could disadvantage stakeholders. However, if these risks materialise, they can be mitigated through existing provisions in the undertaking and through the Authority's monitoring of how the WICET arrangements are implemented in practice.*[6]

Given the agreement of the WIRP users, the QCA did not assess if the WIRP Fee is a reasonable reward for the additional costs and risks claimed or that the additional costs and risks would not be mitigated by a standard Access Agreement with take-or-pay commitments or mitigated through insurance or other financial instruments.

3.2 The Consequences of Light-Handed Approval

The QCA's initial approval of the WIRP Deed on its own is unlikely to be an effective tool to prevent misuse of market power. A more light-handed review of the Access Conditions in the event of user agreement would only be appropriate if the QCA were convinced that users had practical alternatives available to them and could not have been forced into the agreement through the use of the access provider's market power. In the absence of a practical self-funding mechanism, the QCA cannot be satisfied that its initial approval of the WIRP Deed means that it no longer needs to address the issue of market power or consider if the Access Conditions were "value for money" or if customer approvals may have been obtained "under duress".

The combination of light-handed approval by the QCA and the absence of practical alternatives available to the access seekers would represent a regulatory inconsistency if the WIRP Deed were not subject to any ongoing scrutiny. The circumstances under which the

[6] QCA, *Final Decision Wiggins Island Rail Project Stage 1 Rail Infrastructure Access Conditions,* May 2012, page 11, 3rd last para

QCA approval was granted—effectively separating the risks and rewards under the Access Undertaking from the analysis of the Access Conditions—suggest that there is likely to be a mismatch between the overall risks and rewards of WIRP when the Access Conditions and Access Undertaking are considered together.

4 QCA's Ongoing Role

The regulatory inconsistency arising from the historical separation of the analyses of the WIRP Deed and the Access Undertaking does not need to persist. The QCA can ensure that the totality of the access provider's costs and risks are appropriately compensated by the totality of revenue from both the Access Conditions—the WIRP Fee—and the normal Access Charges without addressing the question of whether the WIRP Deed should have been approved or whether the QCA's approval can or should be reversed.

The regulatory inconsistency can be resolved by the QCA assessing the risk and cost implications between the WIRP Deed Fee and the Access Undertaking charges in its consideration of future Access Undertakings.

4.1 QCA acknowledges the need for an ongoing role

The QCA itself has acknowledged this ongoing role in a number of ways:

- In the formulation of the criteria for Access Conditions in UT3, it mandates a rebate process where Access Undertaking costs are also met by Access Conditions revenue—the "no double counting" provision in Clause 6.5.2(d)(ii). This provision isn't limited to assessment at the time of Access Conditions approval, logically the need for a rebate might arise at any future time
- In the approval of the WIRP Access Conditions where the QCA acknowledged that the WIRP Fee might disadvantage non WIRP Fee users but this could be mitigated through *"existing provisions in the undertaking and through the Authority's monitoring of how the WICET arrangements are implemented in practice"*[7]; and
- The numerous references to the difficulties in separating the WIRP costs and risks from the assessment of the costs and risks of the remainder of the CQCN in UT4. In the UT4 Final Decision the QCA states:

> ***Lessons from WIRP***
>
> *The process of establishing reference tariffs for WIRP users has highlighted the complexity surrounding the interaction between expansion prices and existing reference tariffs. In particular, there were three key issues identified during the WIRP process that we consider were not adequately addressed in the expansion pricing framework presented in Aurizon Network's 2014 DAU or our initial draft decision:*
>
> ***Expansion pricing may apply to expansions with substitutable train services***
>
> *In considering appropriate pricing arrangements for WIRP train services, it became apparent that the ability to isolate the costs and risks associated with an expansion is complicated when train services are substitutable between an existing system and an expansion. When train services are substitutable, even if a separate expansion tariff is established, the substitutability of volumes may have the unintended effect of shifting volume risk associated with an expansion to existing customers.*
>
> ***Expansions may be incorporated within existing systems***

[7] QCA, *Final Decision Wiggins Island Rail Project Stage 1 Rail Infrastructure Access Conditions,* May 2012, page 11, 3rd last para

> *Expansions are likely to be interlinked with the capacity provided by existing systems. As such, the benefits or costs associated with an expansion may not be exclusively assigned to expanding users. The allocation of expansion costs and risks may be complex and may require consideration on a case-by-case basis. In such circumstances, it is important to have all relevant access holders and access seekers involved in the decision-making process from the beginning.*
>
> ***Expansions are unique***
>
> *Each expansion will have unique characteristics that will influence the appropriate pricing approach and the allocation of costs and risks amongst users. As encountered during the WIRP process, a particular issue (in this case substitutable train services) may not be adequately addressed through a mechanistic pricing approach. Furthermore, the willingness of existing users to bear some of the costs and risks of an expansion may differ depending on specific circumstances.*[8]

In all of these ways, the QCA acknowledges that the WIRP Deed costs and risks cannot be considered in isolation and only at the time of the Access Conditions approval but must be continuously considered as circumstances change and new information comes to light.

The QCA's original approval of the Access Conditions is unlikely to have been effective in limiting the access provider's monopoly power. Since the incentives for the access provider to invest in the WIRP infrastructure came from a combination of the normal returns through the Access Undertaking as well as the additional returns from the WIRP Fee, the QCA must consider the totality of returns at the time of each Access Uundertaking determination in order to appropriately balance the interest of the access provider and the access seekers.

4.2 A standalone WIRP Fee is not sustainable

The questions we consider is under what conditions it would be viable to structure the Access Conditions framework so that there would be no need for further consideration following the initial approval. For this to be efficient, the costs and risks of the expansion that are compensated by the additional fee must remain essentially separate from the costs and risks associated with the original underlying network, where the costs and risks are compensated through the normal Access Undertaking charges. This is essentially the logic set out in clause 6.5.2 of UT3.

There are two reasons why this a standalone one-off fixed relationship between the WIRP Fee and the normal Access Undertaking charges is not a sustainable construct:

- The evolution of the Investment Framework in UT4 and beyond means that the costs and risks compensated by the Access Charges will change over time and in addition the WIRP arrangements would likely be different if developed within the more effective options and mitigants available in UT4 and future Access Undertakings; and
- The clear separation of a WIRP Fee that recovers only the additional WIRP costs and risks and a normal Access Charge that that recovers only Access Undertaking costs and risks was never tenable and will become increasingly impractical over time as the artificial boundaries between the costs and risks,

[8] QCA Final decision Aurizon Network 2014 draft access undertaking Volume III—Pricing & tariffs, April 2016, page 36

> the users and the physical infrastructure blur and merge over time—if indeed they were ever completely separate.

This means that WIRP Deed Fee is now likely to compensate—to some extent—for risks and rewards that may also be compensated through UT4 and future access undertakings.

The QCA in its commentary acknowledges both of these reasons. In the next two sections we discuss these reasons in detail.

4.2.1 Investment Framework Evolution

The investment framework has substantially evolved since 2010 (UT3) when the WIRP Deed was negotiated. This evaluation means that the context and background in which the WIRP negotiations took place are now materially different and will likely change in future Access Undertakings.

As we discuss in Section 2.4.2, the UT4 Investment Framework is arguably more rigorous than that in UT3 and the user funding option is more developed.

Arguably the UT4 framework creates more risk for the access provider. The UT4 framework imposes strict time limits and information requirements. This gives the access provider less discretion and freedom in their negotiation of Access Conditions and the alternative of user funding is a more credible threat.

The point is not that the WIRP Deed would likely be different if negotiated in a UT4 environment. That is self-evident, but not relevant. The point is that without consideration of the effects of the WIRP Fee, the WACC set by the QCA in UT4 and subsequent Access Undertakings will be estimated on the basis of providing compensation for the costs and risks of the Access Undertaking Investment Framework at the time. Since the investment framework was less risky from the access provider's point of view under UT3, it is likely that at the time, the access provider may have justifiably needed higher compensation for new investment. However, as the risks under the investment framework evolve, the residual costs and risks that have to be mitigated and compensated by the WIRP Fee will also change.

A fixed relationship between the WIRP Fee and the rest of the return granted to the access provider under the Access Undertaking could lead to a misalignment of revenues and risks. Essentially, the access provider could be compensated for the increased risks of a more rigorous investment framework such as UT4 or future Access Undertakings, but still receive compensation for the same risks through the WIRP Fee because they were included at the time of the approval.

An extreme example of this might occur if in a future Access Undertaking, the access provider volunteered to finance all new capacity investments, perhaps accompanied by take-or-pay long term contracts. This would likely result in somewhat higher WACC. However, ff the effect of the WIRP Fee is not considered, access seekers would effectively be paying twice in the allowed return on the WIRP assets: both through the WIRP Fee and through the higher WACC.

Thus, to avoid over-compensating the service provider, the QCA needs to consider both the appropriate level of WACC for the current Access Undertaking and the degree to which past decisions such as the approval of the WIRP Deed compensate for risks that are now included in the current Access Undertaking as a result of changes to the Investment Framework.

4.2.2 Separation Issues

There are a four reasons why the construct of WIRP and non-WIRP costs and risks as being separate and separable is artificial and unviable and over time and as circumstances change will become more artificial and less capable of being considered separately. They are:

- WIRP and non WIRP costs and risks are already merging as acknowledged by the QCA in their UT4 Final Decision
- The distinction between services provided to WIRP Fee users and services provided to non WIRP Fee users will become difficult to distinguish. The train substitution issue acknowledged by the QCA shows that even now separation of services is problematic
- Most of the physical infrastructure, with the exception of the balloon loop, is integrated into and part of the CQCN. The CQCN will be operated, maintained, extended and expanded as a complete whole; and
- The WIRP infrastructure is already majority funded by the "normal" Access Undertaking fees.

This means that the WIRP and non-WIRP costs and risks are non-separable, even in the short term and will likely merge completely in the medium to long term. Even the WIRP Deed itself acknowledges that by year 20, all of the WIRP have been subsumed into the normal Access Undertaking costs and risks.

Costs and risks are already merging

QCA have already acknowledged that the separate consideration of the WIRP and the "normal" Access Undertaking is not practical and in their consideration of UT4 have taken into account the existence of the WIRP in at least two areas:

- **The "train substitution" issue** where users with both WIRP and non-WIRP train paths can arbitrage between the two and gain a financial advantage as a result of the different contractual conditions.

  This occurs as a consequence of the rail freight task for WIRP and non WIRP users will inevitably change over time. Since a user can have both WIRP and non WIRP notional train paths, such a user when faced with a reduction in volume can reduce the usage of its non WIRP paths (where volume risk is shared among users) and maintain its WIRP paths (where it has a take or pay contract). This passes its volume risk onto the non WIRP users. QCA states:

  Under a socialised price or system premium approach, non-WIRP customers are exposed to volume risks associated with WIRP. On this basis, establishing a separate reference tariff (with separate take-or-pay arrangements and revenue cap) for WIRP train services would normally provide greater protection for non-WIRP customers from this volume risk. However, this protection is compromised when WIRP access holders have WIRP and non-WIRP train service entitlements and these are substitutable.[9]

- **The "cost socialisation" issue**—the degree to which the WIRP infrastructure costs should be socialised among all users or quarantined to WIRP users only.

[9] Final decision Aurizon Network 2014 draft access undertaking Volume III—Pricing & tariffs, April 2016, page49

This results from the use by the QCA of an entirely reasonable approach—"average down - increment up". Under this approach:

– If socialising the cost of an expansion requested by a subset of all users results in an overall reduction in costs for all users—that is the incremental cost of expansion < average cost before expansion, then socialisation should occur as it will benefit non-expansion users; or

– If socialising the cost of an expansion requested by a subset of all users results in an overall increase in costs for all users—that is the incremental cost of expansion > average cost before expansion, then socialisation should only occur if non-expansion users receive benefits that outweigh the additional costs.

Even if the second case is true, then there is a debate around the extent to which the non WIRP users benefit. There are a number of identified benefits for non-WIRP users:

– Faster transit and cycle times reduce their costs

– Enhanced system resilience—that is failures have less impact leading to greater reliability

The debate then centres around the value of these benefits, if they can be utilised by non WIRP users and the materiality of any increase resulting from socialised tariffs.

In UT4 for the WIRP costs the QCA identified three options:

– socialised pricing approach—all WIRP and non-WIRP train services pay the same system reference tariff (with combined take-or-pay arrangements and revenue cap)

– system premium approach—a system reference tariff is set, but in addition, WIRP users pay a premium to reflect their higher incremental costs (combined take-or-pay arrangements and revenue cap still apply as described above in the socialised pricing approach)

– separate reference tariff—allocating WIRP costs and volumes to a new coal system or separate expansion tariff for pricing purposes (with separate take-or-pay arrangements and revenue cap).

QCA in their final decision rejected the access provider's full socialised pricing approach and determined that the "system premium" approach should be used.

WIRP and non-WIRP services and users will blur

The distinction between WIRP and non-WIRP services and users will fade over time as new users appear and old users cease or modify their utilisation of services. This will give rise to questions such as:

- If a new user comes on the CQCN, are they are a WIRP or non-WIRP user and do they use WIRP or non WIRP train paths? A new user would use some of the spare train path capacity in the system. How will that spare capacity be attributed to WIRP or non WIRP?
- Similarly, if an existing user with two tranches of capacity (WIRP and non-WIRP) reduces capacity and elects to do so one of its tranches, does the next

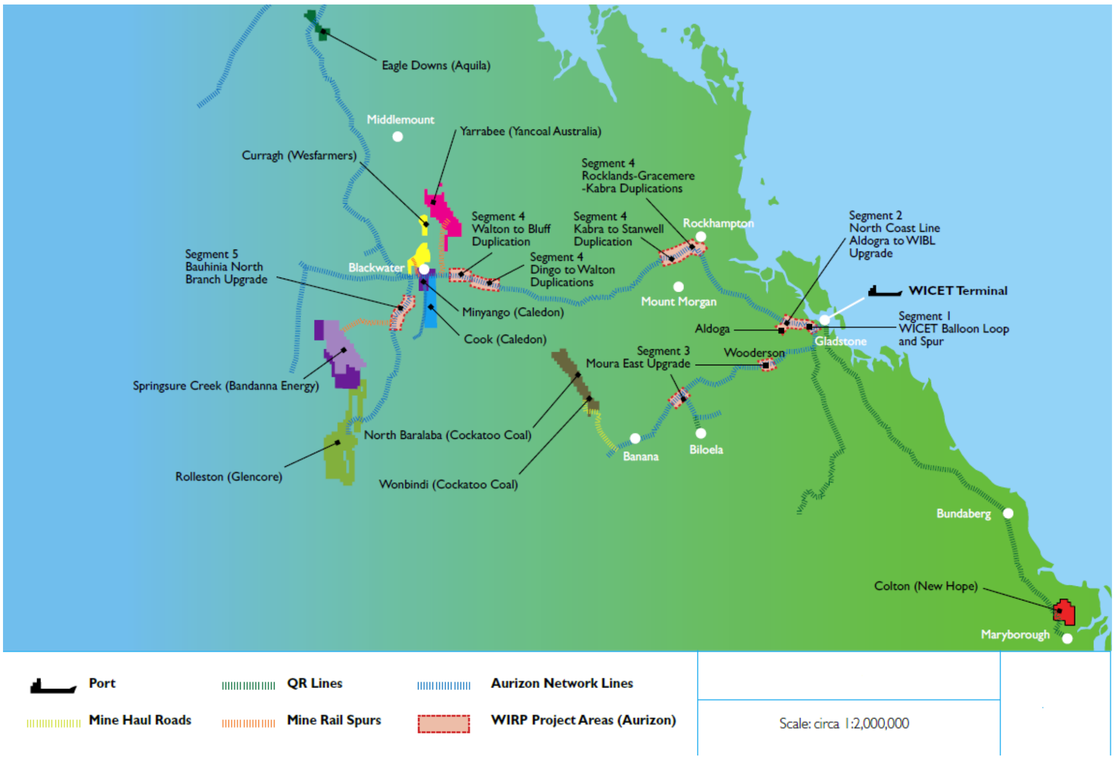
user to increase capacity take up that relinquished capacity on the terms and conditions applicable to that capacity?

The train substitution issue also impacts both WIRP and non WIRP users through the demand forecasts that are a necessary part of the tariff setting in the undertakings. Not only must the access provider forecast total volume, but also the WIRP and non-WIRP volumes. Since the forecasts have a role in the setting of reference tariffs and any system premium tariffs then forecast errors will inevitably cause transfers of cost between the various tariffs and thus WIRP and non-WIRP users. This is a consequence of the QCA adopting a combined revenue cap arrangement.

WIRP Assets are part of the Integrated CQCN

Most of the physical infrastructure in the WIRP is an integral part of the CQCN as shown in Figure 4.1

Figure 4.1: WIRP Segments



Source: WICET

The WIRP works consist of:

- Segment One: WICET Balloon Loop and Spur
- Segment Two: North Coast Line Aldogra to WIBL Upgrade
- Segment Three: Moura East Upgrade
- Segment Four: Blackwater System—line duplication at four locations
- Segment Five: Bauhinia North Upgrade

With the exception of Segments One—the balloon loop—all of the remaining works are upgrades and duplications of main lines in the Central Queensland Coal Network (CQCN). As such, the assets will be used equally by non-WIRP and WIRP users as an integrated network. The CQCN will be operated, maintained, extended and expanded as a complete whole for all users.

This means that costs and risks arising from the physical network will be impossible to attribute directly to a part of the network. As an example, if the overall capacity is affected through a fault on a section of line that has been duplicated through the WIRP, it will be irrelevant whether that fault occurred on the "pre WIRP" bi-directional track or the new WIRP additional single direction track.

WIRP assets are already largely funded by normal AU charges

Since the WIRP assets are included in the access provider's RAB, then the access provider already receives the regulated WACC on its investment and return of capital through depreciation of the combined RAB. Similarly, the WIRP operating costs are also included in the Access Undertaking building blocks. This means that the majority of the revenue earned by the access provider for the WIRP comes through the normal Access Charges.

In Table 4.1 we present a high level analysis of the components of the QCA approved Maximum Allowed Revenue (MAR) in UT4 for the WIRP as a standalone project.

Table 4.1: Estimated Annual MAR Components for WIRP

MAR Component	$M	Notes
Return on Capital (WACC)	64.5	7.17% of RAB—the approved WACC for UT4
Return of Capital (Depreciation)	45.0	5.0% of RAB based on Rolling 20-year asset life
Operating and Maintenance	55.8	6.2% is the average O&M as a percentage of RAB in UT4
Access Undertaking Total MAR	165.3	
WIRP Fee	[redacted]	[redacted]
Total	[redacted]	

The WIRP Fee represents only [redacted] of the revenue received by the access provider for the WIRP—that is [redacted] of the revenue comes from the normal Access Charges from the Access Undertaking

Importantly, as the WIRP assets are included in the RAB, the access provider receives all of its return on and of capital through the normal Access Charges. It also receives compensation for all of its operating costs through the normal Access Charge.

This is because the Aurizon Access Conditions Report and the subsequent QCA approval make it clear that:

- The WIRP fee is not a WACC uplift. In any event a WACC uplift could only be approved if the WIRP resulted in a material change in Aurizon's capital structure or credit rating; and
- The WIRP fee does not recover any additional operating costs. This is because there was no quantification of such additional costs in the Access Conditions Report or the QCA Approval. Further in the UT4 operating and maintenance costs allowance did not seek to carve out any of its current costs that were compensated by the WIRP Fee.

This means that the WIRP Fee can only be attributed to compensation for additional risks.

4.3 WIRP Risk Analysis

In the Aurizon Access Conditions Report, Aurizon claims that the additional risks that are compensated through the WIRP Fee arise primarily as a result of:

- *the significant involvement required by the customer group in directing the design, construction, procurement procedures, cost and delivery of the infrastructure;*
- *the total anticipated cost of the project (~$900m); and*
- *the duration of the project.*[10]

The specific additional risks claimed by access provider and their description of those risks are shown in Table 4.2.

Table 4.2: Additional Claimed WIRP Risks

Risk	Description in the claim
Construction Risks	the risk of costs above the budgeted cost and/or delay in completion of the project
Market (volume) Risks	risk inherently associated with the development of infrastructure requiring significant up-front investment for a return profile that exceeds the users' horizon
Stranding Risks	particularly in a market affected by uncertainties such as the proposed Mining and Resources Tax and the proposed carbon tax and is very dynamic given volatility in demand and prices over time, and the potential competition from other supply chains such as the Galilee Basin
Optimisation Risks	excessive delays to project commitment in obtaining regulatory preapproval of project scope and procurement strategy
Financing Risks	the amount to be raised is significant in a tight market and the risk is further increased by the fact that the timetable for works proposed by the Users requires the funds to be raised over a three-year period
Site Remediation Risks	the risk that QRNN will, in the absence of access conditions, be left with the very real prospect of significant remediation costs at the end of the economic life of the project
Performance Risks	the risk that QRNN will not be able to meet the significant obligations imposed by Users on the delivery of the project and its on-going performance integrity against the background of the control afforded the Users over design and delivery of the infrastructure.

Source: Aurizon Access Conditions Report

In the access provider's Access Conditions Report, there was no quantification of those risks.

In Table 4.3 we analyse the additional risks considered by the QCA in their approval of the Access Conditions. We note that the risks and their description vary slightly between the access provider's Access Conditions Report (see Table 4.2) and the QCA Final Approval (see Table 4.3). Our analysis is of the QCA additional risks as they form the basis for their decision to approve the Access Conditions.

[10] Aurizon Networks, *Access Conditions Report for the Proposed Wiggins Island Rail Project (WIRP)*, 11 May 2011, page 6

Broadly our analysis shows that the additional risks fall into four categories:

- The risk is additional and directly attributable to the WIRP and can be distinguished from non-WIRP costs and risks—**Additional Risk**
- Some additional risk may result from the WIRP but any costs attributable to that risk cannot be cleared distinguished from non-WIRP costs so double counting is possible—**Merged Risk**
- The risk is not additional to those where the cost is recovered through the normal Access Charges—**No Additional Risk**
- The risk is additional but only exists as a result of the WIRP Deed itself and not the project—**Risk Created by Deed**.

In Table 4.3 we present our analysis and categorisation of the additional risks claimed by Aurizon and approved by the QCA to be recovered through the WIRP Fee.

Table 4.3: Additional WIRP Risks considered by QCA

Risk	Category	Analysis
Construction Risk	**No Additional Risk**	▪ Without the WIRP Deed, the counterfactual would likely have been Aurizon proceeding with the works but as separate projects to its own timetable and design. While this may have disadvantaged users, there would be no risk to Aurizon. ▪ It is unlikely, and has never been suggested by Aurizon, that the involvement of the WIRP group resulted in a project that did not represent sound engineering practice and a realistic timeframe. ▪ Cost variations due to "hot" and "cold" market conditions would likely have been deemed prudent by the QCA as being factors beyond Aurizon's control ▪ Construction risks are a normal part of Access Undertakings and appropriately compensated in regulated WACC
Credit Risk	**Risk Created by Deed**	▪ Credit risk is normal part of Access Undertakings and appropriately compensated in regulated WACC ▪ The risk that users will not pay the WIRP Fee is a risk created by the Deed itself and is only valid and justified if the Fee itself is valid
Optimisation Risk	**No Additional Risk**	▪ Completely mitigated by the Optimisation Fee, which is completely separate from the WIRP Fee ▪ It is unlikely, and has never been suggested by Aurizon, that the involvement of the WIRP group would result in a project that did not represent sound engineering practice or was not a prudent response to users' needs for capacity
Asset Stranding Risk	**No Additional Risk**	▪ All other CQCN assets are subject to the same exposure to the coal sector—this is adequately compensated in the regulatory WACC ▪ Substantially mitigated in AU as QCA allows depreciation over shorter period than rail economic life of rail assets (either mine life or rolling 20-year life) ▪ WIRP assets are largely integrated into CQCN so increase in stranding risk is unlikely
Financing Risk	**No Additional Risk**	▪ Regulated WACC is based on capital structure and credit rating of a benchmark efficient entity (BEE) and unrelated to Aurizon's (or its parent's) actual balance sheet. For that reason, considerations such as the opportunity costs of funds to the parent company is not a relevant consideration. ▪ If debt and equity rates had moved substantially since the regulated WACC was set, Aurizon could have mitigated this through a WACC uplift. In fact, rates declined between the UT3 decision and the WIRP Deed execution
Performance Risk	**Merged Risk**	▪ If Aurizon fails to deliver train paths to agreed levels, then difficult to see that the cause can be attributed specifically the WIRP assets or the other CQCN assets. ▪ If a non WIRP user trains derails on a WIRP passing loop and causes delays, is it a WIRP or non WIRP delay? ▪ The WIRP is claimed by Aurizon to make the network more efficient and resilient so, if anything it should lower Aurizon's risks

Our analysis of the additional risks that are compensated by the WIRP Fee suggests that in the main they are not additional to the normal risks faced by the access provider that are compensated by normal Access Charges under the Access Undertaking.

This is not surprising given that the QCA in its approval was not required to consider if the Access Conditions were necessary for the investment, were appropriately quantified and that the risks could not be mitigated by take or pay Access Agreements.

However, the QCA are clear in the development of the Access Conditions mechanism in UT3 and UT4 that the regulated WACC is sufficient reward for the access provider to undertake investments in new capacity under normal conditions and that Access Conditions can only compensate for additional risks and costs. The Access Conditions fee cannot be a facilitation payment to incentivise the access provider to invest.

5 Process for QCA Consideration

There is a compelling case for the QCA to continuously review the costs and risks compensated through the WIRP Deed and those of the Access Undertaking compensated through the regulated WACC as a totality in assessing future Access Undertakings.

The logical process to ensure that the overall risks and rewards are balanced between the access provider and both WIRP and non-WIRP users is through the QCA adjusting the regulated WACC to take account of the effect of the WIRP Fee on the overall costs and risks of providing access and the overall rewards that the access provider receives through the combination of the WIRP Fee and the normal Access Charges.

Thus, the QCA in setting the regulated WACC needs to consider the effect of the WIRP Deed given the inseparability of the costs and risks and the degree to which the WIRP conditions spill over into the Access Undertaking. This is particularly important as the Investment Framework evolves and creates different risk and arguably greater risks for the access provider than the UT3 Framework in force at the time of the negotiation of the WIRP Deed.

If the totality of risks and rewards is not assessed, the access seeker may pay for risks through the WIRP Fee that are now considered part of the normal Access Charges through evolution of the Investment Framework.

On-going re-evaluation and consideration of the WIRP Fee in conjunction with the Access Undertaking does not undermine investment certainty for the access provider. To the extent that the WIRP risks and costs can be shown to remained unchanged and still be additional risks, the fee will remain appropriate. This analysis of the totality of costs and risks is not done with hindsight of past risks but looks forward at risks.

To provide investment certainty, the risks (and the value of the risk) in the WIRP Deed need to be assessed in three categories:

- Risks that are clearly and exclusively WIRP and regardless of whether they are past or future but not yet crystallised, the access provider is entitled to be compensated for that risk. An example of this might be the risk of construction overruns where users required a new and untried technology, if the access provider had agreed to take that risk in return for compensation through some portion of the WIRP fee. This would essentially be an insurance premium that the access seekers had agreed to pay and thus should remain as appropriate compensation—even if post construction the risk did not materialise
- Risk that have not yet occurred but if they do occur they will not be compensated through the Access Undertaking. An example of this may be the credit risk on the WIRP fee itself (providing the remainder of the fee is justified); and
- Risks that have not yet occurred but if they do, will most likely be absorbed and compensated through the normal Access Charges in the Access Undertaking. This is because these risks have been subsumed into the normal risks of being the access provider, either because they are not separable from other risks in the normal course of business or through evolution of the Investment Framework. An example of this may be performance risks. It is unlikely that if the access provider fails to meet its overall performance metrics, it would be possible to allocate the shortfall to either WIRP or non-WIRP assets.

The last category of risk is likely to be already included in the Access Undertaking WACC and it is this category that the QCA should take into account to avoid double counting.

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