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SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY

SUBMISSION IN RESPONSE TO THE AURIZON NETWORK 2017 DAU LODGED WITH THE QCA ON 30 NOVEMBER 2016

17 FEBRUARY 2017

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1. INTRODUCTION

Anglo American Coal Australia (**Anglo American**) welcomes the opportunity to make submissions to the Queensland Competition Authority (**QCA**) in respect of Aurizon Network's 2017 Draft Access Undertaking (UT5) (**DAU**).

Anglo American commends the QCA on the steps taken to commence the compulsory process under the Initial Undertaking Notice (IUN) issued on 11 May 2016, to ensure a timely review and implementation of UT5.

Anglo American continues to be an active member of the QRC's Rail Working Group, having been through previous processes in respect of earlier access undertaking approvals, and generally supports the QRC submission in respect of the UT5 DAU.

Capitalised terms in this submission have the meaning given to them in the DAU. Otherwise references in headings for chapters 1 to 13 refer to the covering submission lodged by Aurizon Network dated 30 November 2016 along with the DAU.

Anglo American understands from the DAU and related materials, that the approach proposed by Aurizon Network is to, in essence, 'roll forward' UT4 with some preferred policy changes in addition to resetting the Maximum Allowable Revenue (MAR) as required, including a 'pricing' review which contemplates a "*revised approach to calculating..[its] cost of capital*". It is noted that Aurizon Network claims to have substantially retained the core policy positions from UT4 in this DAU with only a limited number of changes proposed to address "..*practicality, efficiency, customer specific requests and matters that Aurizon Network believes are beyond the powers afforded to the QCA*."

In relation to the "*revenue proposal*", it is disappointing that Aurizon Network considers that a lowering of the return must be met with a corresponding lowering of the related commercial and regulatory risks. It is a fundamental basis for a build-up of an appropriate WACC that the market parameters which provide objective criteria reflective of prevailing market conditions for all businesses inform and underpin it. Aurizon Network appears to be seeking to overcome the resultant 'delta' by suggesting their risk profile has changed from UT4 in order to secure a favourable WACC outcome which is unsubstantiated. Aurizon Network's revenue proposal for UT5 is also claimed to reflect the "..inherent risks of the network business,.." which it believes are higher than what the QCA has previously considered, which again, Anglo American considers to be an unsubstantiated assertion. The material submitted by Aurizon Network to support such assertions consists largely of generalisations and is therefore unreliable. In Anglo American's view nothing has changed significantly in respect of the 4 major reasons given to support this assertion by Aurizon Network in its submission (at p2) since UT4 was approved in October 2016. In fact, since completion of the Northern Missing Link (linking Newlands system with the Goonyella system) most users in the Central Queensland Coal Network (CQCN) are now physically able to access any terminal, which reduces stranding risk for Aurizon Network across the entire CQCN.

Anglo American also does not accept that record volumes across the CQCN during the UT4 period are entirely attributable to Aurizon Network performance or supply chain initiatives. It is noted that delivery of contracted capacity is yet to be achieved despite capital projects to deliver more capacity in the UT4 period. It is also noted that the RAB value has increased from ~$4.9Bn to over $6.2Bn in that time or growth of ~26%. However, contract is still not being achieved and volumes have only increased by ~5% from 214.5Mt (FY14 actual) at the commencement of UT4 to 226Mt (FY16 actual). It is not only in Users' interests but also Aurizon Network's to ensure delivery of prudent and efficient capacity.

Chapters 3 to 13 of the Aurizon Network submission, these matters are dealt with in further detail below.

UT4/UT5

Anglo American recognises the fulsome process conducted by the QCA in approving UT4 to ensure there would be, amongst other things, an appropriate balance of risk under the revenue cap model between Aurizon Network and users and to improve the transparency of Aurizon Network's activities and operations as they relate to the provision of access to the CQCN under a considerably different Access Undertaking compared to the previous generation (UT3).

As UT4 has only been in effect for some 4 months, it is submitted that there has been insufficient time for all stakeholders to properly understand whether it is an effective Access Undertaking. As such, it would be imprudent to assume it is capable of a few policy modifications and updated for pricing, to become the basis for the next generation of Access Undertaking to be in place for 4 years. Clearly, Aurizon Network is able to make modifications in its own interests through subsequent DAAU's but users do not have that ability. Therefore, Anglo American considers the UT5 DAU process should be treated with caution to ensure UT4's role in UT5 and their impacts are able to be understood whilst maintaining a balanced approach to allow flexibility should the outcomes be undesirable particularly for Users .

Anglo American also considers that there are still some issues from UT4 that require further prescription or which ought be reviewed in the context of UT5 to ensure that Aurizon Network operates in an appropriate and transparent manner so as not take advantage of its market power for access and related services including those that are not-contestable (or barely contestable). These issues are dealt with at the end of this submission.

As noted, Anglo American supports the QRC submission regarding the DAU except as otherwise expressly set out herein.

2. COMMENTS ON AURIZON NETWORK'S SUBMISSION WITH THE 2017 DAU

Chapter 1 – Introduction

Section 1.4 – AN's Improvements in Performance and Productivity

Anglo American does not accept a number of the observations and conclusions drawn by Aurizon Network throughout its submission particularly in relation to Aurizon Network performance and operational productivity improvements to support an overall claim for increased revenue throughout the UT5 period, on the following basis:-

- There is no empirical data or reliable correlation able to be drawn between what Aurizon Network claims to have done and increased volumes or more importantly increased capacity, eg – just because the percentage of change to the agreed plan has reduced doesn't necessarily mean the plan was right in the first place.
- Aurizon Network has expanded the CQCN to provide the capacity for higher volumes.
- However, users are not generally obtaining the volume that they have contracted or are paying for in TSEs.
- Aurizon Network improvements to assumptions are less about actual productivity and more about seeking to meet baseline (static) contract assumptions.

- Other supply chain participants (such as ILC) have also contributed significantly to minimising the deficit between actual volume achieved and contract, as well as finding operational changes to create capacity improvements through collaborative coordination efforts with various stakeholders including Aurizon Network.

- Increased volumes are not necessarily indicative of throughput improvements.

Chapter 3 – Policy Positions

In addition to acknowledging the QRC submission and drafting regarding the various "*incremental changes from the UT4 base line..*" proposed by Aurizon Network, Anglo American makes further observations in that regard under the relevant sections below.

Chapter 4 – Maximum Allowable Revenue (MAR) Proposal

Anglo American notes from the Aurizon Network submission:-

- The proposed MAR would mean an 11% average increase in tariffs across the CQCN (including 14% increase in the Blackwater system and 35% increase in the Moura system, but excluding recently approved 2015 flood recovery costs);
- Aurizon Network's MAR proposal takes issue with nearly every component of the QCA's approach to calculating the MAR in UT4;
- Aurizon Network is seeking to change nearly every element of the weighted average cost of capital (***WACC***), including seeking changes to the QCA's settled approach from UT4; and
- In excess of one third of the total MAR claim is comprised of Maintenance costs (20%) and Operational expenditure (17%), with little meaningful detail provided to support these elements.

Aurizon Network acknowledges that "*..customers have focussed on minimising cost, whilst maximising throughput to continue to improve their unit cost and to drive productivity at their mine sites*." (at p3 of the submission) yet seeks approval of a MAR that effectively increases tariffs by 55c/net tonne across the entire CQCN and despite a reduction in the WACC (compared to UT4). This substantial increase appears largely due to proposed changes to the methodology, particularly regarding inflation and gamma, along with an excessive WACC claim, in addition to proposing to roll more WIRP capital into the UT5 RAB including the majority of the deferred

WIRP revenue. It is also noted that the claimed Operating Costs and Maintenance continue to increase yet the proposed volume forecast remains 'flat' for the UT5 period.

It is noted that the current Aurizon Network MAR proposal (at page 103) seeks to include recovery of ~$234M of WIRP UT4 deferred revenue, as part of the UT5 revenue requirements in respect of which Anglo American makes the following observations:

- There is no clearly established basis for the relevant deferred revenue tonnes coming on line to support this;
- Aurizon Network is effectively making users, who are not in default, bear the cross default risk for non-railing users indefinitely; and
- Aurizon Network undertook negotiations with WIRP project participants on an arms-length basis to the exclusion of non-WIRP users, receiving commercial consideration to undertake the project and any related risks.

Anglo American's views on how expansions ought to be priced remain the same as in UT4 (addressed further below) and remains strongly opposed to cross default risk for expansion projects being borne by parties that are either:

- an access seeker requiring an expansion and being part of a number of other expansion project participants; or
- an existing user, not part of the expansion project, not allowed to be involved in, or vote on, aspects of the expansion project (in this case WIRP).

In the circumstances, Anglo American does not support the Aurizon Network MAR proposal and in particular where it effectively seeks to socialise the WIRP revenue shortfall with other users, whether they be either WIRP project participants or Non-WIRP users.

Chapter 6 – Forecast volumes

Anglo American will make a separate submission on the volume forecasts for each system once the detailed basis for the forecasts are made available for review and the QCA has appointed the necessary experts to conduct a thorough analysis of this aspect of the DAU and UT5 revenue process. It is Anglo American's view that past volume forecasts submitted by Aurizon Network have generally been inappropriate, materially ignoring the individual producer's saleable/railing forecast, and therefore unreliable. This is particularly so where no basis for deferred revenue WIRP tonnes has been made out as it relates to the Blackwater system.

Chapter 7 – Regulated Asset Base (RAB)

Aurizon Network acknowledges that there has been a material increase in the RAB value from its first undertaking and importantly seeks to increase the value by ~$1.4Bn to ~$6.2Bn since the last undertaking (as shown in Fig 30 on p 155). It is concerning in such circumstances that there is a lack of detailed RAB information made available in either the DAU or the Aurizon Network submission. The Submission and its appendices provide the high level RAB values by system. However, Anglo American believes that there should be a detailed (bottom up) build up made available so that Users can see the detailed assets and other granular aspects, including asset write offs, etc making up the proposed RAB value in each system. This information can potentially be made available on line to all interested parties and should not be considered confidential. Clearly the RAB value is critical to the calculation of the MAR.

Chapter 8 – Capital Indicator

Anglo American believes that the proposed Capital Indicator to apply for each system during each Undertaking period should first be presented and then endorsed by a proposed 'Rail Capacity Group' or equivalent made up of the appropriate users of each system, as detailed in earlier Anglo American Submissions regarding UT4, in order to review and support all capital expenditure allowances and projects as part of the Investment Framework subsequently presented to the QCA by Aurizon Network for approval.

There is little detailed information regarding the projects comprising around $778M to be claimed under the Capital Indicator during the UT5 period, which appear to be associated mostly with renewals and no identified expansion projects. The major concerns are:-

- There is effectively no real oversight from a concept or pre-feasibility stage of what projects (other than Expansions in Part 8) are actually required to be undertaken until 'after the fact' however Aurizon Network has built the capital allowance into the tariffs to commence charging for the relevant period;
- Aurizon Network defines the scope and activity of the projects;

- The capital program, particularly as proposed for the UT5 period, is material in value and requires the appropriate scrutiny including how it is built into the tariffs;

- Aurizon Network is clearly incentivised to undertake capital renewal projects, by the nature of the current Undertaking, in order to increase MAR and the value of the RAB.

Chapter 9 – Maintenance costs

It is of note that the maintenance claim has increased from UT4 by some $116M and constitutes ~20% of the MAR, even though the volume forecast on which it appears to be based is relatively flat over the period despite the claim in the submission that there has been an increase in volumes from UT4 to UT5 and a reference to a "greater quantum of RAB infrastructure." (p8 & p144). Again, there is little information detailed by system or the methodologies that underpin the maintenance cost build up/breakdown by system or at all. There is a particular lack of transparent and granular information provided by Aurizon Network in that regard. Overall, it is of concern that there is such a high and in particular increased cost of the maintenance activities proposed for UT5 in circumstances where such a large amount of capital has and is planned to be expended whilst volumes are not increasing in a material way. Due to the lack of detail in the Aurizon Network UT5 submission, e.g. – total annual spend or category by percentage (and not by system), Anglo American is unable to make detailed comments, but makes the following specific observations for the QCA to consider (in assessing what is the appropriate entitlement to 'efficient costs' in discharging the obligations under s138 of the QCA Act):

- *UT4 expenditure as a base*
  Again, UT4 approval of maintenance expenditure by the QCA does not necessarily mean it is appropriate for the UT5 period, noting the claim is 19% higher in nominal terms compared to UT4. In this regard, Anglo American has 2 concerns being: use of the UT4 expenditure as a base line and escalation of that base line to determine a proxy for prudent and efficient UT5 maintenance cost claims.

- *Proportion as direct costs*
  Some 96% of delivering the maintenance scope is stated to be 'direct costs' which provides a major opportunity for review for significant cost reduction. It is noted (at p150) that Aurizon "*maintains built capacity*" which, it is submitted, is

inappropriate particularly where (forecast) volumes are considerably less with no clearly defined targets to reduce such a "*high proportion*.. [of] *fixed costs*".

- *Rail Grinding*

  Aurizon Network states that grinding services are provided under "*a related party service agreement*" by Aurizon Operations (p172) appointed on the basis of benchmarked market pricing (for interstate work) and a competitive tender process. Given that the CQCN could reasonably be considered as forming the core of Aurizon Operations maintenance business through which it can pursue other maintenance business, this should be priced on the basis of 'efficient cost plus reasonable margin' or alternatively at a significant discount to interstate market pricing/tenders rates given the prevailing economies of scale available in the circumstances.

  Anglo American also questions the "market arrangements" Aurizon Network has with Aurizon Operations, in that the grinding costs are mostly fixed.

  Anglo American suggests that the QCA require Aurizon Network to provide evidence by system as to the prudency and scope of the grinding arrangements, including the competiveness of the market based pricing process and assessment. Anglo American also suggests the QCA investigate the Aurizon Network claim regarding the shortfall on grinding budget from UT4.

- *Mechanised Production Activities*
  Activities such as ballast undercutting, rail grinding and resurfacing are said to make up 50% of the total maintenance cost which are fixed. These are all areas that either Aurizon Network or a related party carry out which necessitates further scrutiny as it is in the Group's interests to over scope the activities and claim.

- *New Mechanised Maintenance Assets*

  Although Aurizon Network shows an opex offset for introduction of the new mechanised maintenance assets, it is not clear why overall the opex cost is still higher. Anglo American suggests that greater granularity be required as to the treatment of the capital and operational costs of the new mechanised maintenance assets including description of the (RM902) machinery and related equipment, that it was necessarily acquired in a competitive process, that it belongs to Aurizon Network and if it does, it will be capitalised in 2020 upon completion of commissioning, in which case the claim for opex needs to be reviewed to ensure it is truly opex with no ‘double dipping’ (e.g. – related party services using the Plant & Equipment under a lease or other arrangement from Network, etc).

- Efficient costs
  It is still not clear whether the scope of the maintenance works is appropriately prudent and therefore the amount(s) claimed representative of an efficient maintenance cost. It is submitted that it is excessive in circumstances where Aurizon Network ‘maintains built capacity’ compared to volumes

Chapter 10 – Operating Expenditure

Anglo American requests the QCA to conduct a thorough review of the Operating Expenditure claim by Aurizon Network. In particular, Anglo American draws the QCA’s attention to the following (in assessing what is the appropriate entitlement to ‘efficient costs’ in discharging the obligations under s138 of the QCA Act):

- Again, like the other areas of the submission, there is generally a lack of detail with figures provided as total spend or by cost category without any information as to allocation by system, cost build up, etc.
- Aurizon Network’s opex claim should be approved based on it showing the efficient costs incurred in complying with its access obligations, not arbitrarily escalated arrangements from the UT4 allowance. Aurizon Network (at p207) claims the Operating Expenditure allowance is efficient, but there is no meaningful evidence to that effect other than it being claimed to be relative to the base line for UT4. It is noted this is also only 1% lower in real terms compared to UT4.
- The claim (at p195) for increasing regulatory costs, if any, should be borne completely by Aurizon Network given its failure to deliver various UT3 matters within the regulatory period, eg – SUFA, capacity statements, etc and the approach taken to the UT4 process (effectively ‘rewriting’ UT3 and) submitting the 2013 DAU only a few months before the previous undertaking was due to expire and without any meaningful consultation.
- It is not clear why there has been a change to reallocate the Finance and Network Legal costs from Corporate Overheads to Business Management allocations between the UT4 and UT5 periods. Additionally, it is not clear

from the level of detail provided whether the reduction to the Corporate Overheads allocation equals the increase to the Business Management allocation. It appears much lower.

- The Corporate Overhead allocation claimed (at p199) should also be benchmarked against appropriate entities. It is noted that ARTC, by way of comparison, is a government owned corporation which manages ~8,500km of rail network across 5 states. Brookfield Rail, a subsidiary of Brookfield Infrastructure Partners LP, manages 5,500km of track in WA. It is also not accepted that a 'standalone rail network business' necessarily needs to be an ASX listed company and therefore entitled to allowance for such related overheads. In fact, such costs would be incurred by Aurizon at a Group level in any event whether it had a regulated subsidiary or not.
- It is not possible from the information provided at Table 48 (p201) as to whether the allocation methodologies, as well as build up of costs, are prudent and efficient. Anglo American also queries the non-coal cost allocation shown in Table 48 which has now reduced from 9% to 2%.
- Anglo American does not accept the benchmarking relevance proposed by Aurizon Network (page 206 and later at page 224 section 10.5.2). Under the efficient cost allowance concept, benchmarking has a role where appropriate to compare. In this regard, it is believed that the ACT decisions are irrelevant and Anglo American suggests the QCA consider more relevant comparisons such as ARTC where appropriate and properly validated by relevantly qualified consultants with access to complete information.
- The document is unclear as to the basis for the cost allocation methodology or build up adopted by Aurizon Network noting a reference (at p236) to a proposed "*Approach to Modelling in the Revenue Proposal*".
- Anglo American does not accept that 50% of the cost of the major projects team should now be allocated to the Operating Expenditure claim (page 216). When major projects are undertaken, it is assumed that any such prudent and efficient costs are allocated to those major projects once delivered and therefore form part of annual capital expenditure claims made by Aurizon Network and for which the Capital Indicator already provides an offset. To allow this in such circumstances would be 'double counting'. It is also understood that the Aurizon Network Projects team does other work which

provides Aurizon Network creating a revenue stream outside the MAR for activities it deems are not strictly part of providing the declared service. Access holders are being asked to subsidise the related FTE costs enabling additional revenue opportunities for Network.

- As noted earlier, Anglo American does not accept Aurizon Network's proposition that it's Planning and Development costs have reasonably increased at all due to perceived UT4 or UT5 compliance requirements.
- There is no detail in relation to either the lease or licence costs associated with Corporate offices provided or intended to be provided by Aurizon Operations. Given the record low CBD occupancy and leasing rates, it would be appropriate to understand how this leasing/licence cost has been determined and whether it is reasonable and prudent. It is appropriate for Aurizon Network to disclose the $/sqm tenancy arrangement, as is common for most new leasing arrangements entered into on a commercial basis.
- Given the Head leasing arrangements with the State Government, it is not clear why Aurizon Network is paying commercial rates for multi user operational site tenancies it says are owned by Aurizon Property Pty Ltd.
- The Enterprise Services costs are incurred anyway by the Aurizon Group business. Anglo American does not accept that the Aurizon Network business needs the allowance for an ASX listed company and therefore related costs is questioned for the reasons raised above.

Chapter 11 – WACC

As noted above, Anglo American is disappointed by Aurizon Network's proposal for UT5 in that regard. Anglo American is of the belief that the UT4 WACC should be materially reduced for the UT5 period and that the changes proposed by Aurizon Network are not justifiable. Anglo American supports the position on WACC calculations and reasoning as detailed by the QRC.

Chapter 13 – Reference Tariffs

Anglo American notes Aurizon Network's intention to socialise the existing UT4 WIRP Blackwater revenue deferral and has provided other comments elsewhere in this submission. Anglo American does not believe Aurizon Network should be allowed to 'socialise' the revenue deferrals or RAB expansion capital with either other WIRP project participants (as proposed) or alternately existing users, until there is at least a clear long term financial benefit to those users (e.g- materially reduced existing user Tariffs). It is important that expansion volume is reached and remains for the contracted duration of the project life, not just the current Undertaking period. Otherwise, socialisation would be nothing more than Aurizon Network shedding commercially negotiated and compensated risk to parties that were never part of the arrangements.

3. UT5 DAU

In addition to the above, Anglo American wishes to make the following observations regarding the DAU submitted by Aurizon Network.

Part 5: Access Agreements

Access Rights

Anglo American continues to object to the ability for a Train Operator to hold Access Rights in its own right which is clearly a potential outcome under the definition of “Access Holder” in (UT4 and) UT5. In fact, any “person” that has “Access Rights to operate Train Services..” can be an “Access Holder” which would include any other supply chain participant such as a port owner. Anglo American strongly considers that a Train Operator or any other supply chain member for that matter should only be able to hold Access Rights on behalf of, and for the benefit of, a producer as the end user, particularly given the risk of vertical integration creating adverse market impacts.

Further, in the instance that a Train Operator is able to acquire and hold Access Rights in its own right, it could incentivise the Train Operator to engage in anti-competitive conduct through a secondary market. The risk is exacerbated where the regulated below rail monopoly services are transferred to an above rail duopoly enabling control of below rail pathing allocation on a daily, weekly or monthly basis through commercial prioritisation of above rail interests of the haulage provider.

With further modification, the new transfers processes, once streamlined will allow adequate flexibility and liberation of underutilised capacity with producers able to trade pathing through their respective haulage providers holding the capacity on behalf of their customer.

If vertical integration is permitted to occur in ports, there may be incentive for the vertically integrated entity to discriminate in favour of its own above rail operator or its customers, particularly if it holds rail access in its own right. Under the current access framework, a service provider will be able to contract for Access Rights in its own right which would enable the service provider to purchase below rail and terminal rights, bundle these rights with above rail services and to sell to producers at an unregulated price through a secondary market. Although it would theoretically remain open to the producer to seek additional pathing and terminal rights under the access regimes, if the application for those rights trigger an expansion, this would be unnecessary and avoidable. Further, the producer may not be able to obtain the rights and be forced to purchase bundled rights.

In times of surplus capacity this may not appear to be problematic but single branch lines and track access into the terminal precinct will mean such situations are capable of arising where the track capacity is held by non-producers looking for increased revenue through commercial incentives by bundling above and below rail services and potentially 'exit capability' through further vertical integration.

To prevent or reduce the risk of this type of anti-competitive conduct, Anglo American submits that only end user producers with 'supply chain rights' should be permitted to hold Access Rights.

Flexibility

Anglo American is of the view that the Standard Access Agreement along with the other related aspects of the DAU (eg – Schedule G, System Operating Parameters, System Rules, etc), which is how the regulated services are delivered, provides insufficient flexibility for users to overcome system losses and address requirements for surge capacity. Users are required to have sufficient 'matching' port capacity to contract track capacity. To overcome the combined consequences of a 'capped' monthly track entitlement allocation and system operational losses in addition to variable production and railing to cargo assembly ports, users are forced to over contract to ensure that they will have sufficient capacity to meet forecast peak railings and offset lower production periods due to outages where monthly entitlement is not able to be used, so the entitlement is effectively lost. Where contracted capacity is insufficient, users are then forced to rely upon "ad hoc" pathing to address any surge in throughput which comes without certainty, particularly if contested.

Anglo American considers that it is essential that users are provided with sufficient flexibility in their railings where the capacity is available. By way of example, the ARTC Hunter Valley contracting model allows for the ability to flex up to +10% (subject to a cap on maximum train paths) in any given calendar month with the entitlement used being counted to overall annual contracted capacity. Such a system gives users flexibility in railings to assist in better utilising annual port entitlements and catch up or surge as required around monthly TSE's. Provided spare capacity is available on any given day, this would enable users to utilise each others' unused capacity when not peaking at the same time, rather than have to rely on "ad hoc" pathing and potentially contested path processes or transfers which can be time consuming, requiring additional resources. This would also facilitate better system utilisation and therefore reduce overall 'Take or Pay' exposure.

Anglo American also reiterates its comments in its submission to the UT4 Draft Decision that the Access Agreement still contains a focus on weekly fixed scheduling and monthly entitlement. These rigid scheduling restrictions are detrimental where flexibility is required in order to maximise supply chain efficiency and the delivery of supply chain capacity is to be achieved by releasing latent capacity. This is particularly unfavourable to users, especially those reliant upon cargo assembly ports, by ignoring the related requirements for cargo assembly 'campaign' railing which contributes even further to the need for peaking requirements.

Part 6: Pricing Principles

Section 6.4 Access Charges for coal carrying Train Services that require an Expansion

Anglo American agrees that the approach to Expansion pricing in relation to a rail network has proved to be problematic and continues to submit that it should be considered on a "case-by-case" basis. This is particularly so where it is not clear whether the expansion is being triggered by new users and/or whether existing users will benefit by way of more capacity. However, it is submitted that the nature of the expansion should first be considered before applying the 'incremental up/average down' test used by the QCA in the past. By way of example, if an expansion is triggered by a new mine or mines requiring not only connection to the existing network but incremental enhancement of the mainline, then the incremental costs should be paid by the user triggering the expansion, so that existing users are no worse off. It is submitted that to apply a pricing impact test in any situation means existing users are exposed to cross default risk in the future should the new user(s) not produce the required volumes.

Anglo American strongly supports the concept that users requiring an expansion pay an access charge that reflects at least the full incremental costs for capex and opex required to provide the additional capacity where that can be determined.

Anglo American generally supports the proposition that existing users should also be no worse off and not experience an increase in tariffs due to an expansion triggered by access seekers. However, Anglo American strongly considers that this principle does not go far enough to protect existing users from single basin developments and similar mine projects triggering expansions.

Anglo American continues to be of the view that existing users should not be required to take any cross default risk of access seekers (i.e. competitors). This cross default risk is realised when expansion project volume does not materialise. What Aurizon Network is proposing in relation to the deferred WIRP revenue in UT5 produces that outcome and effectively transfers any cross default risk back to other users under a socialised system. In the current WIRP revenue deferral proposal, this risk is passed back to railing WIRP users. Anglo American is concerned that this is one step from socialising all WIRP project costs with WIRP and non WIRP users, in order for Aurizon Network to spread the risk it entered into on a commercial basis.

Anglo American is also of the view that, in assessing whether an Expansion might provide a new and higher Tariff than existing Reference Tariffs, a portion of Common Costs (for various fixed services provided by Aurizon Network for train control and other Aurizon Network operations to be used by the expanding user) should also be included in the new Expansion Tariff.

Anglo American considers that it is appropriate for users of services to contribute to the cost of providing such services which are a normal part of accessing the Network. Anglo American continues to consider that the true test of whether the Expansion Tariff for a particular mine haul is able to accommodate a portion of Common Cost is whether that Expansion Tariff is actually higher on a dollar per net tonne basis, rather than the Reference Tariff of an existing user with the longest haul to that same unloading destination and adjusting for differences in train characteristics. This ‘access to market’ view is more realistic and practical, taking into account the ability to pay by a producer.

Section 6.13 Access Conditions

Anglo American supports the QRC’s submission and proposed mark up of the UT5 DAU. Anglo American considers Aurizon Network’s drafting changes to section 6.13

do not consider materiality appropriately and seek to potentially limit the powers of the QCA and QCA Act, to the detriment of users.

In addition, Anglo American requests the QCA to consider that Aurizon Network should not be allowed to determine an access application requires access conditions where the items are not material to risk but rather simply to the provision of an Access Agreement (e.g. changes to the access application for commencement of railings or volume).

Part 7: Capacity Allocation

Section 7.3 Renewal

Alignment of renewing Access Agreement term with port entitlement

Anglo American understands the need that any rail expansion infrastructure requires a minimum term for access agreements to provide a secure framework for Aurizon Network investing in the network. However, for existing rail infrastructure and capacity, Anglo American considers that any Access Holders that have previously held their access under an agreement for at least 10 years should be able to renew for a lesser period, but it is suggested no less than 5 years. This would enable better alignment with ‘exit capability’ generally being the minimum, ‘evergreen’ renewal right period for most port capacity linked to the CQCN, while keeping the future renewal "first rights" alive. This ability to align term expiry dates between track and port, together with the assurance of future access rights renewal, will allow users to better align their significant take or pay commitments and capacity.

Section 7.4.2(q) Short Term Transfers

Anglo American remains generally supportive of the UT4 short term transfer mechanism for UT5. However, the regime is too restrictive as a Transfer Fee may be payable for the transfer if it is for contracted capacity with a different Reference Tariff. This is likely to dis-incentivise users from utilising the short term transfer mechanism. Anglo American believes that, while other users should not be disadvantaged or impacted by a short term transfer, there should be scope to broaden the application of the short term transfer mechanism to ensure that as much capacity as possible can be transferred to increase the total usage of network capacity and subsequently increase overall efficiency and throughput on the network. It also requires simplification in order to make it workable. Anglo American is generally supportive of the drafting proposed by the QRC regarding the transfer processes.

Section 7.4.3 Relinquishment

Anglo American is supportive of the QRC proposed drafting changes to clause 7.4.3.

Part 7A: Baseline Capacity

It is noted that Aurizon Network has significantly altered the Baseline Capacity process in their proposed UT5 drafting of section 7A. It is understood that some changes to this clause are required due to the initial (UT4) Baseline Capacity Report being required to be undertaken and provided to the QCA and industry and that the Capacity Assessment process under Part 7A.4 will be the annual 'refresh'. However, Anglo American does not support the concept that once the Baseline Capacity Report is provided under UT4, then there is no further reference to that assessment to the extent that any alternative process varies from the outcomes this current process requires.

Anglo American suggests that the Baseline Capacity concept is not deleted, but that the Report is updated annually through capacity assessments, with a yearly updated Baseline Capacity Report to be provided to the QCA and industry via the updated annual NDP document. This would then enable any changes to the System Operating Parameters, Network Management Principles, etc, to be captured in one comprehensive document.

In relation to the Aurizon Network proposed drafting changes to clause 7A.4.3 dealing with Capacity Deficits, Anglo American does not support the changes to capacity deficit arrangements and the ability to dispute who funds. It is recommended that the UT4 provisions are reinstated, including the ability for an expert review to be undertaken.

Part 8: Network Development and Expansions

Section 8.2.2 Disputes under Part 8

Anglo American does not support the deletion for disputes from expansion funders and recommends the QCA reinstate the applicable UT4 drafting.

Section 8.5 Study Funding Agreements

Anglo American provided a draft Study Funding Agreement with Anglo American's suggested amendments to be considered as part of UT4. Anglo American wishes to reiterate the suggested drafting in Anglo American's draft Study Funding Agreement to the extent that they were not adopted for UT4 by the QCA and now also become relevant for UT5, in particular:

(a) the inclusion of an additional condition in clause 2.7 that a variation has had a material impact on the study;

(b) the requirement for Aurizon Network to carry out the Rail Study in accordance with good industry practice (amended clause 7.1);

(c) the approval of the scope of works and target study costs (clause 7.3);

(d) the restriction on varying the scope of works without approval of the study funding committee and the process for varying the scope of works (clause 8.2);

(e) the removal of the requirement for a Bank Guarantee (clause 12);

(f) the right to give a dispute notice where Aurizon Network does not provide reasonable details of the calculation of the Provisional Project Management Fee (clause 13.2);

(g) the removal of the limitation on Aurizon Networks liability (clause 18.2);

(h) the removal of the right for Aurizon Network to assign its rights under the Agreement (clause 19.2); and

(i) the requirement for Aurizon Network not to disclose information under the Study Funding Agreement where it would breach its Ringfencing obligations under the Access Undertaking (clause 20.2(b)).

Section 8.7 Funding an Expansion

Anglo American does not support the proposed clause changes to allow Aurizon Network to unilaterally fund an expansion prior to SUFA funding options, unless Aurizon Network also agrees to a minimum mandatory funding obligation for expansions.

As previously submitted under UT4, Anglo American believes that until a SUFA model is tested and workable, Anglo American does not support the removal of a regulated expansions regime from the Access Undertaking. It is fundamental to the provision of regulated access that the provider be required to invest in prudent and efficient expansions at the appropriate WACC as part of providing the declared service. Even following the implementation of SUFA, there should be some form of expansion principles to address scenarios as an alternative to the SUFA model or which require a regulated outcome.

Anglo American continues to believe that because of its natural monopoly position, Aurizon Network's ability to engage in economic hold-up to the detriment of the capacity and efficiency of the CQCN, and subsequently Access Holders and the supply chain, must be managed. Anglo American believes that this is most appropriately done by ensuring that Aurizon Network is required to expand the CQCN in certain specific and controlled situations, all of which were considered appropriate under UT3 and have proved an invaluable alternative to a workable SUFA.

Anglo American also notes that regardless of whether any expansion is user-funded or funded by Aurizon Network, ultimately it is a "user pays" system.

Section 8.8.3 Development and Review of the SUFA

Anglo American does not support the Aurizon Network proposed drafting to limit the QCA's ability to improve workability of the SUFA documents and QCA oversight of the SUFA arrangements and refers to the QRC submission in that regard.

Section 8.9.3 Capacity Shortfall

Anglo American does not support the deletions made within clause 8.9.3 by Aurizon Network and refers to the QRC submission in that regard.

Section 8.9.4 Funding a Shortfall Expansion

Anglo American does not support the proposed deletion of clause 8.9.4 by Aurizon Network. Anglo American notes that under Part 8.9.4, Aurizon Network must fund any Shortfall Expansion where the Capacity Shortfall was caused (partly or wholly) by the default or negligence of Aurizon Network. Anglo American notes that Aurizon Network should be responsible for funding any Capacity Shortfall as users will have already paid for capacity which has not been delivered but identified by Aurizon Network through the related feasibility studies and in the Capital Indicator.

As a minimum, the threshold should be lowered so that Aurizon Network must fund any expansion where there is a Capacity Shortfall and it is unable to demonstrate that it acted as a reasonably prudent provider in conducting and delivering the capacity in the Expansion. Aurizon Network should also be required to consult with Affected Access Holders prior to undertaking any steps to deliver the Shortfall to determine whether the additional cost of remedying the Shortfall is still to the benefit of Affected Access Holders eg – whether cheaper operational solutions can be developed and whether any additional costs should be rolled into the RAB.

Part 10 – Reporting, Compliance & Audits

It is appropriate that the requirement for a Conditions Based Assessment be maintained and provided at the beginning and end of each Undertaking 4 year period to ensure the appropriate assessment of the RAB and related maintenance and opex is determined. Where Undertakings are extended in term past 4 years, then the next Assessment should fall due on its original due date, as if there had been no extension of term.

Schedule E: RAB

RAB Reconciliation with Line Diagrams

Anglo American believes that the QCA should require that the RAB, which drives the MAR, is in line with the current Line Diagrams submitted by Aurizon Network as part of the Undertaking. This requirement should include an obligation for Aurizon Network to facilitate an independent audit of the RAB assets against the Line Diagrams and to ensure the RAB is appropriate for the services provided.

As previously identified by Anglo American in its submission responding to the UT4 Draft Decision, Aurizon Network's RAB will have been calculated from these asset divisions, and therefore, Anglo American does not believe that this is a large task and should be completed by an independent assessor appointed by the QCA and provided with sufficient information by Aurizon Network to complete and provide to the QCA an accurate assessment within six months of the commencement of UT5.

Anglo American believes that this process should be repeated prior to any new MAR being calculated, with updated information provided by Aurizon Network. This will ensure any amendments to the Line Diagrams are reflected in the RAB and MAR calculations. Anglo American does not see this annual process as an expensive or time consuming process and is naturally part of developing the MAR in anticipation of each regulatory period for approval.

Section 4 Voting on capital expenditure

Anglo American suggests that a robust, pre-expenditure capital approval process such as the ARTC Hunter Valley Rail Capacity Group concept should be implemented instead of some of the post expenditure processes currently within UT4 and the proposed UT5. This would avoid reviewing expenditure claims for projects after the event and allow iterative and proactive involvement by those underwriting the proposed projects on the basis of merit, scope and cost. The process should cover expansion capital projects and renewal capital works. Alternatively, this could be considered for UT6.

Schedule F: Reference Tariff Variations

Section 5.3 Review Event Process

Anglo American understands that the Review Event process is an important framework for protecting Aurizon Network, in particular, from incurring significant losses where there have been major unforeseen events which have damaged the CQCN infrastructure. Anglo American has previously made submissions to the QCA expressing its dissatisfaction with the Review Event process for various reasons and reiterates its view that it is not the most appropriate manner to address events such as flood damage recovery costs. Anglo American has the following concerns with the current process:

- Aurizon Network does not proactively include users in any detailed understanding of the recovery/repairs process and cost build up leading to the Review Event claim at the time of the event;
- The repair cost is not transparent to either users or the QCA, as the prudency of capital repairs are assessed at a different time to when the claim for operational costs is lodged, neither having the informed involvement of users required to pay these costs;
- The quantum of the repairs when considering combined capital and operational claims is always material, particularly so for users of smaller systems such as the Moura system;
- There is no hard and fast rule prevailing over some track infrastructure repair line items being classed as operational, as opposed to capital;
- Application of Aurizon Network insurance coverage (external, internal and self insurance) is never clear;
- The Review Event recovery, once approved, becomes an un-budgeted cost for users and, it is submitted, inappropriate to unilaterally change forecast

expenditure budgets of the users unnecessarily by being able to recover a material cost impact during the current financial year (i.e. – retrospectively) after a Review Event decision is made by the QCA. This is exacerbated by the process being concluded well after the time from which Aurizon Network has sought to recover payment from, as commonly occurs, causing a large once off ‘bullet’ payment (in the absence of any informed basis for an accrual) and then a ‘price shock’ for the balance of the period which is significant in systems with fewer users;

- Aurizon Network makes a windfall gain by having the Review Event recovery costs escalated at WACC (applicable for a full year escalation period), rather than a normal holding cost of debt, such as a bank overdraft rate. It is noted that with the recent 2015 Flood Review Event, of the final approved ~$4.7M cost recovery amount, approximately $0.7M is associated with escalation. It is submitted this makes the Review Event a ‘revenue raising’ exercise for Aurizon Network, not a cost pass through mechanism;

For these reasons, Aurizon Network is not incentivised to process and seek approval of Review Events quickly, in particular, regarding flood recovery costs. Anglo American considers that the Review Event mechanism is not the most appropriate way to deal with these flood related claims. Anglo American suggests the QCA require:-

- Flood related events be treated separately to other Review Events;
- That all related prudent and efficient costs are treated as operational or capitalised appropriately and treated as part of the Aurizon Network Capital Expenditure claim process as a renewal; and
- The cost recovery is included in the tariffs from the time of approval (and not retrospectively) to be reconciled in the annual revenue reconciliation process until recovered based on usage not ‘Take or Pay’.

4. Residual issues

These issues, which Anglo American wishes the QCA to consider further, include:

(a) Self-insurance - the inclusion of more prescriptive details in the Access Undertaking around the manner in which matters (assets and events) are funded using self-insurance collected from users;

(b) Dispute Resolution - the expansion of the dispute resolution process to expressly permit a party to bring a dispute where it is an Access Holder (or Access Rights are held on its behalf by a Rail Operator) and the issue relates to its Coal System;

(c) Confidential Information - the express ability for Aurizon Network and stakeholders to provide Confidential Information to the QCA to assist it to make an informed decision.

(d) Form of Regulation - Anglo American continues to be of the view that the form of regulation imposed on Aurizon Network should be subject to a complete 'blank sheet' review. The inordinate delay in presenting the 2013 DAU, until its final approval and implementation in late 2016, has impacted on the ability for a comprehensive approach to the consideration of the 2016 DAU in this context.

Given the need for UT5 to be in place by 1 July 2017, the form of regulation and its components should be the subject of a complete review well in advance and in anticipation of the next DAU (UT6) due 2021. Although this may appear a long way off, the complexity of the regulatory regime, especially when starting afresh, cannot be forgotten.

Anglo American submits that it is appropriate to consider whether Aurizon Network, in its transition from a government owned corporation to a privately owned subsidiary of a public listed company, is now sufficiently mature to transition to a ‘price cap’ (or other) form of regulation. Price cap regulation, for example, is more likely to incentivise Aurizon Network to increase efficiency on the network as the decreased costs will represent increased margins. A price cap form of regulation would also reduce Aurizon Network's incentive to overcapitalise on its investment in the network. Anglo American continues to consider that a price cap form of regulation is more aligned with a competitive market because it would permit sharing of volume risk. As UT6 approaches, it is submitted that other forms of regulation need to be considered given the outcomes of previous undertaking periods and processes.