GLENCORE

Mr Charles Millsteed
Chief Executive Officer
Queensland Competition Authority
Level 27, 145 Ann St
Brisbane QLD 4001

12 March 2018

Dear Mr Millsteed

# Submission to the Queensland Competition Authority
# Redacted version for publication

Glencore is pleased to make this submission to the Queensland Competition Authority (**QCA**) in relation to issues raised in the QCA's Draft Decision (dated December 2017) in respect of Aurizon Networks' 2017 Draft Access Undertaking (**Draft Decision**).

Glencore wishes to acknowledge the effort of the QCA in examining the 2017 Draft Access Undertaking (**UT5**) and notes the important contribution that this process makes to the future of the Queensland Coal Industry and for the State of Queensland generally. It is important that this oversight continues and we are a strong advocate for the continuation of monopoly Network regulation.

Despite the efforts of the QCA, the current UT5 process has failed to produce a final outcome prior to the commencement of the regulatory period, introducing uncertainty for all parties. While partial responsibility must be borne by Aurizon Network for this outcome, given the timing of the original draft access undertaking and the voluminous late submissions made by Aurizon Network in October of last year, we believe this raises the question of how far in advance of a regulatory period the QCA should commence the mandatory process. The UT5 (and UT4) processes demonstrates that at least 2 years may be required to produce an outcome and therefore that the process for UT6 should commence 2 years in advance of the expiry of UT5. This would avoid the imposition of retrospective decisions, which of course is one part of Aurizon's justification of its current actions in respect of maintenance practices.

More generally Glencore would support a review of the regulatory process. The current undertaking process is lengthy, cumbersome and introduces uncertainty for all parties. Adding further complexity to the same already complex regulatory structure every four years is resulting in an almost-indecipherable access undertaking document, reducing the transparency and therefore the efficacy of the regulatory process. To this end, Glencore would support a review of the process upon after the making of the final UT5 decision. This process should start from a zero base and take into account other frameworks in use that may be working well elsewhere.

**Performance and incentives**

Glencore firmly supports any measures which can improve the efficiency and productivity of the coal supply chain, and is willing to consider the application of appropriate incentives to achieve these outcomes. However, any such mechanism in the context of Aurizon Network must address the challenges which arise.

The creation of theoretical rail capacity in isolation of other elements of the coal supply chain creates no economic benefits to anyone and should not be rewarded. The efficiency of the rail network must be measured by its effectiveness as a part of the entire coal supply chain from pit to port – it is the capacity of the entire supply chain which generates economic value, not of any individual part of that supply chain. Therefore, the measurement of the capacity generated should be in the hands of an independent body, which is separate from each stakeholder in the supply chain but open to participation from all of them, which can take a holistic view of the entire coal chain. Such a body already exists in the Hunter Valley in the shape of the HVCCC. From our perspective as a global coal miner this is the most effective model for a multi-user coal chain.

The other side of the efficiency equation is the cost of delivery of the system capacity, of which the rail network forms a part. The difficulties which arise for any "ex ante" mechanism which set a budget and then exposes Aurizon to the risk or benefit of under or overspending include:

- It is difficult for users of the network to make an informed view or to provide realistic comments on any draft budget given that we are not able to access any detailed information on the operation of the network. Therefore, it will be hard to set a budget in which users have confidence.

- It is difficult to form a view on whether under or overspends against budget are caused by efficiency or by changes in scope. This is particularly the case given our lack of detailed knowledge about network condition at any point. Currently, we also lack the necessary insight to determine whether cost savings have been brought about in ways which adversely impact upon system capacity and therefore do not necessarily increase efficiency (in fact, if a cost saving is sufficiently destructive of network capacity, it may have a negative effect on efficiency).

Because of these difficulties, we believe even the current level of incentives provided to Aurizon Network by means of the setting of the operating and maintenance budget for each regulatory period in advance may not in fact be the optimal way of addressing this issue. An "ex post" assessment of the expenditure in each year, with a pass through permitted for efficient expenditure, would in our view better protect the interests of the users. Although there would be limited incentive for Aurizon to attempt to increase its efficiency, this would at least remove any incentive for Aurizon to game the system or to budget for expenditure which is unnecessary. This would also remove any justification for Aurizon to change its maintenance regime so as to reduce system capacity, as it has recently done.

**Capacity assessment and delivery**

Glencore has concerns about the reliability of current assessments of Network Capacity, in particular the UT4 Draft Baseline Capacity Assessment. There is an asymmetry of information between Aurizon Network and its users in relation to the determination and delivery of capacity which makes it very difficult to make sensible future investment decisions, because of the degree of uncertainty which arises.

Glencore does not consider that the proposed auditing provisions contained in UT5 are efficient or sufficient based on our previous experience. The way that these arrangements appear to work is that

Aurizon Network maintains a model to which the QCA's consultants have been provided limited access in order to conduct a model review. Based on our understanding, the degree of review conducted would not have been sufficient to qualify as a model audit. In any event, our concern is that the model output does not bear a sufficiently close relationship that the rail network is actually able to deliver as part of an integrated coal chain.

Glencore strongly believe that Aurizon Network's proposed annual assessment of system capacity contained in UT5, should be conducted by an independent body and be robust enough to allow access seekers / holders, train operators and customers to make informed business decisions, not for information purposes only. In the Hunter Valley, the HVCCC is able to plan capacity on an integrated basis because it is a body which is independent of any individual participant in the coal chain, but which provides all participants with the opportunity to be a part of the process.

While it may not be possible to achieve the same HVCCC structure in every coal supply chain in Queensland, we certainly believe that the provisions in respect of capacity should be strengthened. The model should be developed and maintained by an independent party, and that party must be provided with sufficient information to ensure that the model can reflect realistic planning assumptions for both the Aurizon Network and for other elements of the coal chain.

Assumptions should be clearly identified and transparent to the extent possible without breaching confidentiality provisions. This allows coordinated planning to occur across all elements of each coal chain and therefore maximizes the efficiency of each coal chain as a whole.

Glencore understands that this process may require additional funding, however the greater certainty with which capacity can be understood would provide great benefit to all stakeholders by maximising the economic output and efficiency of coal chains as a whole.

Because of the shortcomings of the current mechanisms to hold Aurizon Network accountable for the delivery of capacity, Glencore believes that over contracting of capacity has occurred. That is, Aurizon Network may have contracted to deliver capacity in excess of the physical capacity of the system.

Access agreements contain a number of exceptions which excuse Aurizon Network's poor performance, such as force majeure or scheduled maintenance, and in any event the measure of the capacity delivered is not aligned with the requirements of the system as a whole, so that Aurizon Network can argue that it has performed adequately on a hypothetical basis.

Furthermore, the information imbalance between Aurizon Network and the customer mean that even the limited contractual rights which access agreements provide are insufficiently effective to hold Aurizon Network to account. For example, Aurizon Network issues hundreds of "force majeure" notices annually which excuse it from any contractual consequences for poor performance, but it is practically impossible for any individual user to verify the occurrence of the event, the impact the event has on capacity, and whether Aurizon Network had in fact taken all the necessary steps to prevent or mitigate the effects of the event.

Aurizon has incentives to expand its revenue base by contracting to provide additional capacity on the network, with little recourse for the customer if the capacity is not able to be delivered. Although the revenue which Aurizon Network is permitted to earn from a particular coal system is capped by the Maximum Allowable Revenue, it may still be able to directly earn increased returns from providing additional capacity to a user (for example, through the returns on connecting infrastructure) and in any event it will diversify its revenue base through adding additional users. In addition, Aurizon Operations may derive benefit from contracting to provide additional above rail haulage capacity on the basis of the contracted track capacity, and if those services are not ultimately able to be delivered because of a shortage of track capacity then it is likely that Aurizon Operations will not be held accountable, since rail haulage agreements will typically exclude Aurizon Network caused losses from any performance regime.

Therefore, Glencore believes that an independent assessment of capacity prior to the provision of any additional access rights should be conducted by the independent party nominated to maintain the capacity model. We also seek regular reviews of available capacity for each system with exact customer requirements modelled in detail with assumptions benchmarked to current actual performance standards.

**Wiggins Island Rail Project (WIRP)**

Glencore remains concerned by the approach that the QCA has taken to the Wiggins Island Rail Project. As part of its UT4 decision, the QCA retrospectively determined to apply a methodology which could be summarized as "incremental up, socialise down". In doing so, the QCA has assumed that the incremental users of the Blackwater system are those customers forced by Aurizon to execute "WIRP Deeds" in order to synchronise the availability of track capacity with the availability of the Wiggins Island Coal Export Terminal. The QCA has also assumed that WIRP produced additional capacity which was truly incremental to the capacity of the Blackwater system which Aurizon Network has claimed pre-dated WIRP. Glencore is not aware of what evidence the QCA has for either of these conclusions. Even if an incremental up, socialise down approach is taken, this requires a proper assessment on which users are incremental users and what capacity (and therefore costs) are incremental.

As outlined in the submissions made by the WIRP users to the QCA previously, we do not believe that the capacity delivered by WIRP was in fact incremental to the existing capacity of the system as claimed by Aurizon. Although it is difficult for us to prove (given that only Aurizon Network is in possession of the necessary information), we are strongly of the view that prior to the WIRP being undertaken the Blackwater system was incapable of delivering the capacity which Aurizon Network claimed for it. To the extent that this is the case, the WIRP capacity cannot be regarded as incremental. Glencore is convinced that a major portion of the "incremental" mainline capacity built under the WIRP is being used by non WIRP access holders to rail non WIRP tonnage i.e. without the WIRP enhancements, the Blackwater System would be currently running significantly below its pre WIRP capacity limits. Glencore does not believe that any further capital / revenue should be included in the RAB until such time as it is evident the incremental capacity has been delivered and that the expansion was not required to service existing contracted paths.

The points we have made in relation to validity of capacity assessments also have implications for the treatment of the WIRP costs. Capacity assessments undertaken by Aurizon Network underpinned decisions relating to the UT4 decision on WIRP allocations. More specifically, Aurizon Network capacity assessments proceeded on the basis that main line duplications were not necessary to satisfy existing contracted paths prior to WIRP. This played a significant factor in the expansion negotiation process, and the QCA's decision not to socialise the costs of duplications with non-WIRP Blackwater users. Glencore understands that the QCA is currently finalising a review of the Baseline Capacity Assessment and expect that any findings which may put in doubt the capacity assessed prior to WIRP should trigger a review of the QCA's approach.

Even to the extent that the WIRP capacity was truly incremental to the existing system capacity at the time of its construction (and remains truly incremental over time), mainline WIRP capacity is not segregated to the exclusive use of the parties to the WIRP Deed. All system users have the same rights to access train paths irrespective of whether they executed the WIRP Deed or not. The effect of the QCA's approach is therefore that the cost and capacity risks attaching to the building this incremental capacity have been allocated only to the parties to the WIRP Deed, but those parties do not receive special or exclusive rights to utilise the capacity which they have underwritten. Instead, this capacity is shared on the same basis by all system users, including those who are protected from any of the incremental costs or risk.

Further, the effect of the QCA's decisions appears to be that the WIRP Deed signatories are treated as the incremental users of the system, rather than any other customers. Generally, the determination of which users of a system are incremental would require an assessment of whether the additional capacity demanded by the user was incremental to the capacity of the system at the relevant time. The parties which signed the WIRP Deed were forced to do so by the necessity to co-ordinate the availability of rail capacity with the availability of the Wiggins Island Coal Export Terminal which they proposed to construct. Had it not been for this requirement of co-ordination, then each customer could have sought capacity in its own right and would not have formed part of any notional grouping of customers. It need not have been the case that Aurizon Network would have constructed additional capacity to meet the demands of any particular customer. In fact, we believe that after the execution of the WIRP Deed, other customers were provided with additional capacity and therefore in any proper assessment should have been classified as incremental customers in the same way as the WIRP Deed parties. Further, Glencore proceeded on the basis that some of its existing network capacity was re-purposed to haul to Wiggins Island, and to that extent it did not demand incremental capacity.

Finally, even if an "incremental up, socialise down" approach is taken in relation to the costs of provision of capacity, it does not necessarily follow that any individual incremental user should be exposed to the risk that other incremental users do not honour their commitments or become insolvent. It is not within the control of any individual incremental user whether Aurizon Network requires the capacity which that incremental user seeks must be a part of an expansion project which will deliver capacity to multiple parties. The identification of expansion projects relevant to capacity requests is within the control of Aurizon Network and not the access seeker. Any individual access seeker is not in a position to manage the risks which are posed to by any other access seeker. Aurizon Network as the infrastructure owner is in a much better position to manage and control these risks. Certainly any access seeker is in no better position than any other users of the existing system to manage such risks.

The QCA has indicated that it proposes to approve the cessation of deferred WIRP Blackwater capital/revenue in UT5 (but not in the Moura system). Glencore is opposed to this cessation. The continued deferral of WIRP costs is NPV neutral to Aurizon Network and appears unlikely to increase Aurizon Network's risks of being able to recover these amounts to the extent that the QCA permits it to do so in the future.

Glencore is also firmly of the view that remaining parties to the WIRP Deed should be not subjected to the default risk brought to bear by other non-railing WIRP participants. Glencore has calculated that Rolleston will bear ~85% of the deferred WIRP costs, which appears egregious given the benefits that WIRP has brought to the Blackwater and Moura systems and given that this was never agreed to by Glencore – and was not contemplated by the access undertaking which prevailed at the time Glencore executed the WIRP Deed.

The QCA has apparently relied in its decision to cease deferring any part of the WIRP costs within the Blackwater system on the fact that Aurizon Network did not specifically assume the risk of customer insolvency in its access conditions submissions. This decision instead imposes that risk on a limited number of access holders (i.e. the WIRP Deed parties), when it is equally true that those access holders did not execute any document in which that risk was assigned to them. It seems unreasonable of the QCA to assume that any risk arising from the provision of infrastructure should rest with the customers of that infrastructure unless otherwise specified by the infrastructure owner.

**WIRP – Allocation of cost**

In the Draft Decision the QCA stated that it is seeking views from affected WIRP users and Aurizon Network, including consideration of alternative allocations, as between the WIRP users.

The following extract from the Draft Decision shows the allocation of capital between WIRP pricing groups.

**Table 9 Aurizon Network's proposed WIRP pricing approach, allocations (%)**

| ***Non-electric*** | ***WIRP pricing groups*** | | |
|---|---|---|---|
| Capital expenditure to be allocated[1] | WIRP Blackwater | WIRP Rolleston | Existing Rolleston |
| WIRP balloon loop | 15.8 | 64.5 | 19.7 |
| Blackwater duplications | 15.8 | 64.5 | 19.7 |
| Bauhinia North | | 100 | |
| North Coast Line | 15.8 | 64.5 | 19.7 |

*1. Note: Capex amounts allocated relate only to UT5 non-railers, that is UT4 deferrals and Caledon.*

The Existing Rolleston capacity should not be allocated any costs for Blackwater duplications or the North Coast Line, since the Existing Rolleston capacity relates to existing system capacity held by Rolleston prior to the execution of the WIRP Deed. Glencore has discussed this with Aurizon Network, which has agreed that the proposed approach was incorrect and that their response to the Draft Decision would be amended accordingly. Glencore is unsure as to what percentage of the UT4 capital was allocated to Existing Rolleston, and ask the QCA to ensure that only Balloon Loop capital has been included.

The Draft Decision notes that WIRP capital had been allocated on a gtk basis for all WIRP contract holders. The expansions relate to specific segments, and have been allocated to those customers that utilise them. The total length of a customer's haul is entirely irrelevant to the use of particular segments. This method has inappropriately allocated more cost to the Rolleston Mine as it represents the longest haul. Glencore discussed this issue with Network during the UT4 process. Aurizon Network appeared to concede during that discussion that this allocator was inappropriate, however it did not have any impact on tariffs during that period due to socialisation, so we are unaware what allocator was used in the final determination. Glencore propose that the allocation of total WIRP capital be made on the number of contracted paths over these segments.

The approach currently proposed in UT5 to allocate deferred WIRP capital appears to enable non-WIRP customers to get a "free ride" if they commence railing to WICET (via ad-hoc paths or changed destinations in access agreements). With unused capacity being available at WICET there is no doubt that non WIRP Users will begin to ship from there in the near future. Glencore suggest a "Balloon Loop Fee" or some other "Conversion Fee" for non-WIRP customers railing to WICET, to the extent that any WIRP customer is paying a premium for WIRP paths. These fees should be used to either reduce the premium payable by WIRP customers or form the basis of a rebate not unlike those in user funded expansion agreements. Without this type of arrangement, WIRP customers will be locked into paying for this capital for the entire UT5 period, irrespective of any changes in WICET utilisation that may occur over this period.

Glencore notes that Rolleston Mine is currently charged a premium for non-electric tariffs, however, are forced to share a lower electric tariff by way of socialisation. This results in Rolleston Mine paying the maximum tariff on both counts. Cherry picking rates between non-electric and electric for socialisation unnecessarily penalises any customers failing the socialisation test. Once a socialisation test is failed, the entire tariff structure should be stand alone. Glencore request that the QCA amend the rules around the socialisation test to remove this anomaly.

Based on these considerations, Glencore believes there are two methodologies in dealing with this now problematic matter (either of which could be phased in over a period of time):

- Allocate a portion of the WIRP costs to each incremental user (based on a robust assessment of what capacity is truly incremental and applying a consistent methodology to identify incremental users which is not dependent on whether any party executed the WIRP Deed) that reflects that users' true share of the costs based upon the capacity that was sought by that user by allocating the costs of each segment among the parties which demanded the relevant capacity. Costs so determined should either be deferred for those not yet operating, or added to the Regulated Asset Base. Costs for users which demanded capacity which have since defaulted should either be deferred (if there are still reasonable chances of a project commencing) or be socialized across all Blackwater (or Moura as applicable) users; or

- Mainline WIRP costs should be socialized across all Blackwater (or Moura as applicable) users reflecting the capacity that was added to the system and that is now benefiting all users. WICET loop costs should be recovered on a user pays basis from those using the loop.

**Network maintenance costs**

Glencore support the QCA's approach to the evaluation of Aurizon Network's maintenance expenditure and processes. Glencore is in agreement with QCA's proposed amendments and further note that it has, on numerous occasions, discussed maintenance closure strategies with Aurizon Network and encouraged it to adopt less frequent, longer closures to complete maintenance tasks more effectively and as such with less impact upon throughput. Glencore has also found Aurizon Network schedule large blocks of maintenance time which has meant regular trains cannot be scheduled to large volume loadpoints without unacceptable dwell.

Maintenance reporting systems appear to require some improvement, as evidenced by Network's inability to produce availability measures for specific branch lines on request. As noted above, availability assumptions are made in capacity assessments, however, there does not appear to be any readily available data for which customers, or Network, can test the validity of these assumptions. Network appears to be indifferent as to, and unaffected by, whether it is meeting its capacity assumptions.

We note recent correspondence from Aurizon Network which claim that there are errors in the analysis and maintenance costing approach adopted by the QCA. To the extent that such errors exist or there are legitimate concerns raised by Aurizon Network (noting that we have not been advised as to the specific concerns held by Aurizon Network) then we support this being taken into consideration in the final determination of the undertaking.

**Reporting**

Reporting for Customers is considered inadequate, with presentation of data being unclear at best, making it difficult for customers to understand the basis on which data has been gathered and presented. Specifically:

- Targets are not published in Network reports, with all comparisons made only to the previous month or for the same month in the prior year. There is very little valuable variance analysis as a result. The use of traffic light reporting without targets is meaningless and in some instances misleading. Meaningful targets should be defined via clear transparent KPI's and reported regularly (at least monthly with a subset reported weekly).

- Generic "System" reports are issued which are meaningless for nearly all individual users. Glencore have requested changes to reports, only to be told that they are generic reports and changes for specific customers will not be considered. By adopting this "one size fits all" approach we end up with "one size fits no body". Glencore encourage other users to engage with Network in order to improve the quality and relevance of reporting for each user. This lack of customer engagement and support is further evidence of Networks monopolistic attitude and highlights the importance of the QCA in pushing change upon Aurizon.

Yours sincerely,

***Submitted Electronically***

Anthony Pitt
Coal Assets Australia
Glencore
E: anthony.pitt@glencore.com.au
www.glencore.com

**Confidential Annexure – Not for publication**

**[Redacted]**