QUEENSLAND resources COUNCIL

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Aurizon Network's April 2014 extension DAAU

The Queensland Resources Council (QRC) appreciates the opportunity to provide feedback on Aurizon Network's April 2014 Draft Amending Access Undertaking ("DAAU").

The QRC supports many elements of the DAAU and appreciates the efforts of Aurizon Network ("AN") to consult with coal producers and the QRC prior to finalising the DAAU.

FY2014 Final Reference Tariffs:

AN proposes to:

- Finalise FY2014 reference tariffs based on the transitional reference tariffs.
- Finalise FY2014 System Allowable Revenues ("SARs") based on transitional SARs.
- Return/collect any difference between the SARs and actual revenue through an adjustment charge.
- Subject to approval as part of the UT4 process, smooth any difference between the FY2014 SAR (as finalised under the current DAAU) and the allowable revenues for FY2014 approved under UT4, across the remainder of UT4 (i.e. FY2015 to FY2017).

AN's letter to the QCA of 8 May 2013 sets out the process which AN intended to implement in the circumstances where UT4 tariffs are not approved prior to 1 July 2014. The process now proposed is consistent with AN's 2013 letter, except that the final FY2014 adjustment was to be made through a second adjustment charge, rather than being smoothed over the remainder of UT4.

QRC understands that AN's proposed departure from the original process has been based on feedback from a number of customers. The approach now proposed by Aurizon is supported by Anglo American, BMA,BMC, Ensham Resources, Glencore, Peabody Energy, Rio Tinto Coal Australia, Sojitz Coal Mining, Yancoal Australia and Wesfarmers Curragh. However, as coal producers do not have a unanimous view in regard to this issue, we have provided a discussion of the merits of alternative approaches in Attachment A. We understand that AN is open to either approach and to having this matter determined through the UT4 process.

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QRC also understands that this matter does not need to be resolved as part of the current DAAU process, however, in the interests of providing certainty for industry, we have a strong preference that the QCA indicates (as part of its decision under the current process) which option the QCA will support in regard to the final FY2014 adjustment under UT4.

FY15 Transitional Reference Tariffs:

QRC supports the extension of the term of the undertaking and generally supports the methodology used to establish interim FY15 tariffs, which is similar to the methodology adopted for establishing interim FY14 tariffs.

We note however that Aurizon Network seeks to reflect the recovery of costs associated with the 2013 flood event in the transitional tariffs for Blackwater and Moura systems. The impact of the adjustment is very significant in the case of Moura (25% increase in tariffs). QRC considers that the adjustment should be excluded from transitional tariffs in Moura because:

- Aurizon Network's claims for these costs have not yet been accepted by the QCA; and
- The question of whether any approved claim should be recovered within FY15 alone, or smoothed over the term of UT4, has not yet been resolved.

QRC suggests that flood recovery costs should be excluded from interim Moura tariffs, and that the question of whether the final approved claim should be recovered within FY2015, or over a longer period, should be resolved as part of UT4. QRC accepts that, if QCA supports the exclusion of these costs from the FY15 interim tariff, this should not be taken as indicative of the QCA's views in regard to the final treatment of this item under UT4.

Other matters:

- Volume forecasts: QRC accepts the forecasts proposed by AN for FY2015 on the basis that these are used solely for the purposes of developing interim tariffs and that final FY2015 forecasts will be determined through the UT4 process (including for the purposes of TOP triggers).

- AT1: QRC accepts AN's proposed treatment of AT1 under this DAAU on the basis that the final approach (including whether AT1 remains a truly variable revenue item) is determined under UT4.

- Interest on Adjustment Charge: As was noted in AN's Explanatory Memorandum, AN's proposal to escalate the Adjustment Charge at an interest rate, rather than at the UT4 cost of capital, is not consistent with the arrangements agreed with the QRC for the 2013DAAU. AN has indicated that this creates no long term NPV benefit for AN, because AN will retain a slightly greater proportion of revenue collected (i.e. refund less) under this escalation approach, and this higher retained revenue will be factored into the calculation of FY2015-17 allowable revenues. QRC is comfortable with the revised approach to escalation, provided the QCA is comfortable that the impact on AN in NPV terms over the term of UT4 (compared to escalating the Adjustment Charges at the final UT4 WACC) is neutral.

The QRC appreciates the opportunity to provide feedback on the DAAU. We would be pleased to discuss any of these matters with the QCA. We confirm that this letter does not contain confidential information and may be made public.

Yours sincerely

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Attachment A: Producer views on final FY2014 true-up

OPTION A: Final FY2014 adjustment smoothed over FY2015-17: (as proposed by Aurizon)

(a) Provides certainty for FY2014

This approach provides maximum certainty in regard to the FY2014 year. The process allows producers to rule off FY2014 and to cease estimating and carrying provisions for later adjustments. The uncertainty regarding tariffs to date has been a significant burden for industry in setting budgets and reporting performance. It is not acceptable to create a situation in which the true cost of access for the FY2014 year is not known until many months after completion of that year.

(b) Avoids complexities and further debate regarding TOP calculations:

There is significant uncertainty in regard to how Take or Pay would be applied in the case where there are two FY2014 adjustment charge processes, as there is no indication as to whether TOP would be:

- finalised based on the transitional tariffs or
- billed on an interim basis with an later recalculation upon finalisation of UT4, or
- deferred until final amounts can be calculated.

The existence of caps which limit TOP collections to the shortfall against SAR complicates these issues.

(c) Provides immediate cashflow relief:

For a majority of producers, and on a net industry-wide basis, AN's proposal provides a significant return of access charges (~$40m net). This is welcomed given the extremely difficult conditions being experienced by industry in 2014. However, this amount is of little value (and is possibly of negative value) if producers face the risk of handing back some or all of the refund upon finalisation of UT4. Producers will be unable to bring any benefit of the refunds to account if final FY2014 tariffs remain uncertain. In the worst case, producers may be required to hand back the refunds, with escalation, in a matter of months after receiving the funds. In this case, industry will effectively be paying interest on a short term loan of funds which (due to the uncertainty) could not be applied to any useful purpose. Immediate relief in the form of the proposed refunds is important to industry, and this relief should be locked in by ensuring that any subsequent true-up is smoothed over FY2015-17.

OPTION B: Final FY2014 adjustment (upon approval of UT4) recovered as an Adjustment Charge:

(a) Provides certainty due to consistency with AN's 2013 letter to the QCA

A second adjustment charge upon finalisation of UT4 is consistent with the process outlined in AN's 2013 letter to the QCA, which was supported by the QRC at the time. Departing from the process which was indicated at that time creates uncertainty in regard to regulatory processes and in formulating responses to these processes. Responses to the 2013 Extension DAAU were based on AN's proposed approach, and different responses may have been provided had the alternative approach been flagged. For example, some producers felt that the interim tariffs proposed for their system were excessive, but were willing to accept these tariffs given that there would be a full true-up upon finalisation of UT4. These producers may have opposed the interim tariffs had they known that any excess revenue would be refunded over a three year period. The QRC's 2013 submission on the extension DAAU noted that "*the use of certain methodologies and assumptions in the development of* *interim tariffs in no way suggests that those assumptions or methodologies are supported (by QRC, coal producers, or Aurizon) for the purposes of UT4*". Interim tariffs were not, and were not intended to be, an estimate of final UT4 tariffs. It is therefore inappropriate that these tariffs be locked in as final tariffs for the first year of UT4.

(b) Prevents inequities between producers:

While deferring adjustments may be NPV neutral for AN, this is not the case for individual producers. For example, if the interim SAR for FY2014 is high relative to the final amount determined for UT4, a deferred adjustment will favour expanding/new producers and disadvantage producers who rail relatively high tonnes in FY2014. An adjustment charge which distributes adjustments based on contracts held and tonnes railed in the relevant year is more consistent with a 'user pays' approach. In addition, take or pay impacts do not offset over time. For example, producers who pay 'capped' take or pay in FY2014 would, under the deferred adjustment approach, permanently pay too much or too little TOP relative to the true FY2014 UT4 revenue requirement.

(c) Prevents adverse impacts on industry competitiveness in later years:

Interim FY2014 tariffs are, in some systems, significantly below those proposed by AN in its 2013 draft undertaking (proposed UT4). This creates a substantial risk that finalising FY2014 tariffs at the interim levels will artificially inflate FY2015-17 tariffs, impacting on industry competiveness over an extended period.

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