

A photograph of a railway track stretching into the distance under a bright sun. The track is made of steel rails on wooden sleepers, with gravel ballast. The sun is high in the sky, creating a lens flare effect. The background shows some dry vegetation and a clear sky.

# Aurizon Network's 2014 DAU Draft Decision: Policy and Pricing

Queensland  
Competition  
Authority

January 2015

# Draft Decision – 2014 DAU

On 30 January 2015, the Queensland Competition Authority (QCA) released a Draft Decision on Aurizon Network's 2014 Draft Access Undertaking (2014 DAU).

The QCA's draft decision is to not accept the 2014 DAU proposed by Aurizon Network.

Instead, we have released proposed amendments to Aurizon Network's 2014 DAU, and our reasons for the draft decision.

Overall, our draft decision reflects our view that the 2014 DAU needs to strike a better balance between the interests of Aurizon Network and its customers.

Our amendments are intended to make the access regime more transparent and, wherever possible, simpler. We consider these changes are necessary to improve the overall productivity of the coal supply chain.

In the 2014 DAU, Aurizon Network has proposed significant changes to the access arrangements for the Central Queensland Coal Network (CQCN). We must assess whether the proposed changes satisfy the requirements of Queensland's access regime.

The 2014 DAU has been the focus of exhaustive stakeholder consultations since it was first lodged in April 2013.

We welcomed the collaborative approach shown by stakeholders, particularly evident during 2014.

All parties have a common interest in enhancing the efficiency of the industry's supply chain, especially in the current challenging economic conditions.

# Themes of the 2014 DAU Draft Decision

The overall approach we have taken to meet the requirements of the QCA Act in making our Draft Decision has been to:

- increase transparency and the flow of information between Aurizon Network, miners, train operators and other supply chain participants with the objective of improving the productivity of the coal supply chain
- provide greater confidence to access holders that contracted access rights can be provided, support the development of a more flexible access rights trading arrangement, and avoid the need for unwarranted investment in infrastructure
- provide improved information and confidence to stakeholders that access is being provided on a non-discriminatory basis
- enhance the performance reporting arrangements so that access seekers and holders are better informed about CQCN performance, including on major items such as maintenance costs
- provide safeguards to balance Aurizon Network's position as a monopoly provider of infrastructure in the expansion of the network so it cannot unreasonably extend the time or request returns for infrastructure provision to gain commercial advantage
- wherever possible, make the 2014 DAU access arrangements simpler.

The objective of Part 5 of the QCA Act 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'.*





## Background to Draft Decision: 2014 DAU

# About the QCA

The QCA is an independent statutory authority established in 1997 to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

Our role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

Our role has expanded to allow us to be directed to investigate, and report on, any matter relating to competition, industry, productivity or best practice regulation, and review and report on existing legislation.

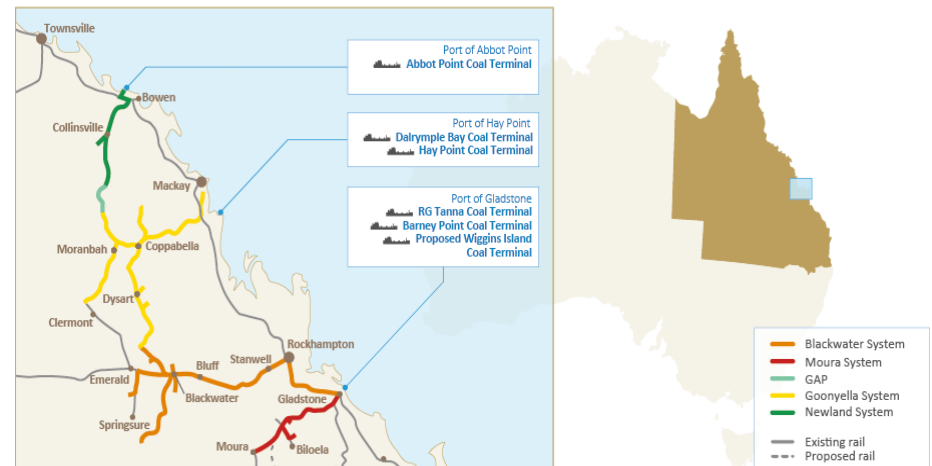
Our role is to  
improve the  
prosperity of  
Queenslanders by  
promoting  
competitive markets,  
productivity and  
better regulation.

# About Aurizon Network and the CQCN

Aurizon Network is a wholly owned subsidiary of Aurizon Holdings Limited.

Aurizon Network owns and operates the below-rail network (the CQCN) and is responsible for negotiating access with parties seeking to use this rail network.

The CQCN is the largest coal rail network in Australia. The CQCN is made up of five coal systems: Newlands, Goonyella, Blackwater, Moura and Goonyella to Abbot Point (GAP).



Aurizon Network is part of the broader coal supply chain in central Queensland, carrying coal from mines either for export or for domestic use

Aurizon Network has held 99-year leases of the CQCN assets since July 2010. The term of the leases may be extended for rolling periods of 99 years following 20 years notice.

# CQCN – third party access regime

Access regulation supports competition by enabling third parties to access essential infrastructure which cannot be economically duplicated.

The CQCN is declared for third-party access in accordance with Part 5 of the QCA Act.

As a result, Aurizon Network (as access provider) and access seekers are subject to various rights and obligations under the access regime.

Under the access regime, Aurizon Network and an access seeker—who wants to secure access to the network—must negotiate in good faith to reach agreement on the terms and conditions for access.

If agreement cannot be reached, either party may refer the dispute to us for resolution under the QCA Act.

Aurizon Network's access undertaking establishes the principles that guide negotiations for access to the CQCN.

This increases certainty and minimises the potential for access disputes to arise.

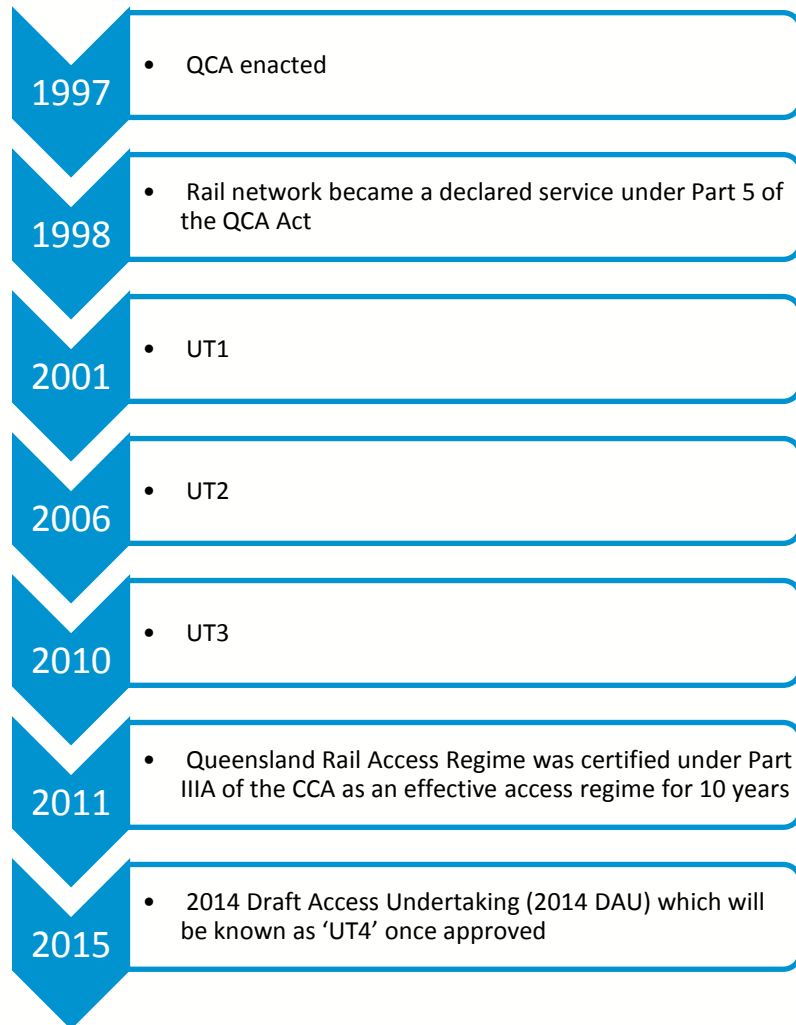
Parties can agree to other terms and conditions on a case by case basis – but if negotiations fail, we resolve disputes in accordance with the access undertaking.

Aurizon Network generates revenue in the form of access charges to the network.

Access to the network (including the revenue Aurizon Network is entitled to earn) is regulated in accordance with the QCA Act.

Aurizon Network's existing undertaking (UT3) is set to expire in 2015.

# CQCN regulatory history



Rail access regime commenced in 1997.

The CQCN was declared under Part 5 of the QCA Act for third-party access.

The QCA administers the access regime.

In 2010, ownership of CQCN was separated from the government owned corporation Queensland Rail, and listed on the ASX.

In 2011, the Queensland Rail Access Regime was certified under the *Competition and Consumer Act 2010* (Cwlth) (CCA) as an effective access regime for 10 years.



# Objectives of an access undertaking

An access undertaking sets out the general terms and conditions for negotiating access.

Aurizon Network's access undertaking includes:

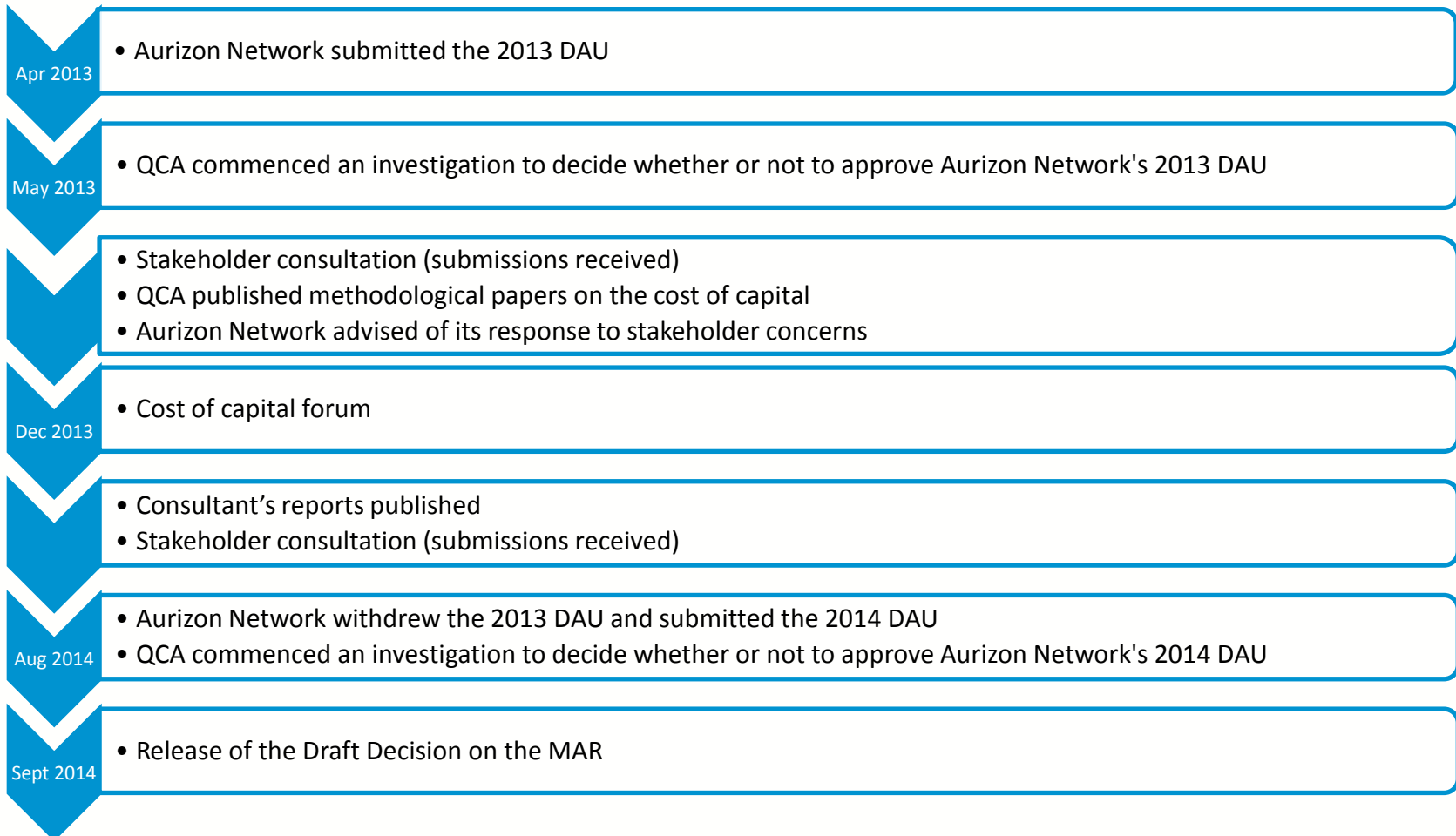
- the framework for access negotiations
- ring fencing arrangements
- utilisation of network capacity
- pricing principles (reference tariffs) and the mechanism for varying those tariffs
- reporting.

An access undertaking increases certainty and minimises the potential for access disputes to arise.

Parties can agree to other terms and conditions on a case by case basis – but if negotiations fail, we resolve any disputes in accordance with the access undertaking.

An access undertaking establishes the principles that will guide negotiations for access.

# 2014 DAU process to date





# Governance

# Intent and scope of the 2014 DAU

Part 2 of Aurizon Network's 2014 DAU establishes duration, intent and scope of the undertaking.

We propose to accept many elements, including:

- majority of intent (objective) clause and scope clause—but have moved the non-discrimination principles into Part 2, to make clear they apply to entire undertaking
- a commitment about the supply and sale of electricity—but clarify that dispute resolution applies
- not requiring inclusion of Associated Services—may not be part of declared service
- the duration and application of Reference Tariffs— effective for the period 1 July 2013 to 30 June 2017.

We also propose inclusion of:

- a clause similar to UT3 non-discriminatory treatment clause—to emphasise the importance of non-discrimination in provision of the declared service
- ports, coal mines and third parties with commercial agreements, in non-discrimination principles—to preclude favourable treatment of related parties
- a process for implementing an incentive mechanism—recognising benefits of a well developed mechanism for UT4
- a requirement to notify if AN not owner of land—to improve transparency and efficiency of negotiation.



# Ring fencing

An effective ring fencing regime is critical to ensuring effective competition in upstream and downstream markets, and promoting customer confidence and trust in Aurizon Network's actions.

Our Draft Decision is to not accept Aurizon Network's proposed 2014 DAU ring fencing arrangements.

We propose using the UT3 ring fencing principles as a base, and enhancing them to provide a clearer set of safeguards regarding the flow of confidential information, including by strengthening requirements.

We consider these arrangements will allow Aurizon Network to structure itself in a manner which supports its legitimate business interests, while providing stakeholders with confidence about the management and use of confidential information within the Aurizon Group.

## 2014 DAU Draft Decision ring fencing obligations

Ensure Aurizon Network executive management does not have any management for a related operator or related competitor (port or mine)

Increase the requirements for recording the disclosure and use of confidential information

Maintain a high risk personnel register

Require Aurizon Network to advise the QCA of all employee transfers and secondments from Aurizon Network to other parts of the Aurizon Group

Provide mandatory training for all Aurizon Network personnel on the management of confidential information and all Aurizon Group employees receiving or having access to confidential information

Retain an annual conflicts audit process.

# Reporting requirements

The reporting regime informs all stakeholders on network performance.

We broadly accept the reporting arrangements proposed for the 2014 DAU with some changes including:

- reviewing the **Costing Manual**
- **simplifying** the **maintenance cost** and performance **reporting** to one report (instead of two) available to the QCA and stakeholders
- requiring Aurizon Network to provide a maintenance and renewals **presentation** to stakeholders before each financial year
- requiring Aurizon Network to provide operational information for stakeholders on a **monthly basis**—rather than quarterly—basis.

To support the **ring fencing** arrangements we are proposing:

- the QCA, rather than Aurizon Network, be responsible for appointment of the compliance auditor
- an annual compliance audit be continued
- a clear conflicts audit process, be included with the intent of identifying potential systematic areas of discrimination
- that Aurizon Network be obliged to provide signed non-standard access agreements to the QCA to allow for monitoring of the non-discrimination arrangements.

# Dispute resolution and decision making

A robust, cost effective and binding dispute resolution process:

- gives parties confidence that negotiations proceed in a meaningful manner in accordance with the intent, obligations and processes of the undertaking
- ensures parties are held accountable for their conduct, decisions and performance.

We have proposed the following amendments to Part 11 of the 2014 DAU:

## Broadening the scope

- Ensure provisions in Part 11 apply generally to obligations in the access undertaking with dispute resolution available to all relevant parties

## Refining the processes

- Simplify the process and provide certainty for resolution, without being unnecessarily prescriptive or onerous
- Keep the QCA adequately informed about the progress and outcome a dispute
- Ensure outcome of disputes is binding



# Access



# Negotiation framework

Aurizon Network proposed a negotiation framework, including:

- key steps in the process
- information requirements at each stage (for all parties).

Stakeholders considered the 2014 DAU addressed some, but not all, of their concerns.

We have considered Aurizon Network's proposal and stakeholder comments and proposed changes to address three key areas of the 2014 DAU:

## Clarifying and streamlining

- obligations and processes for negotiating and applying for access
- incl. in relation to cost recovery, cessation of negotiations and requirements to help negotiations proceed in a timely manner.

## Improving information flows

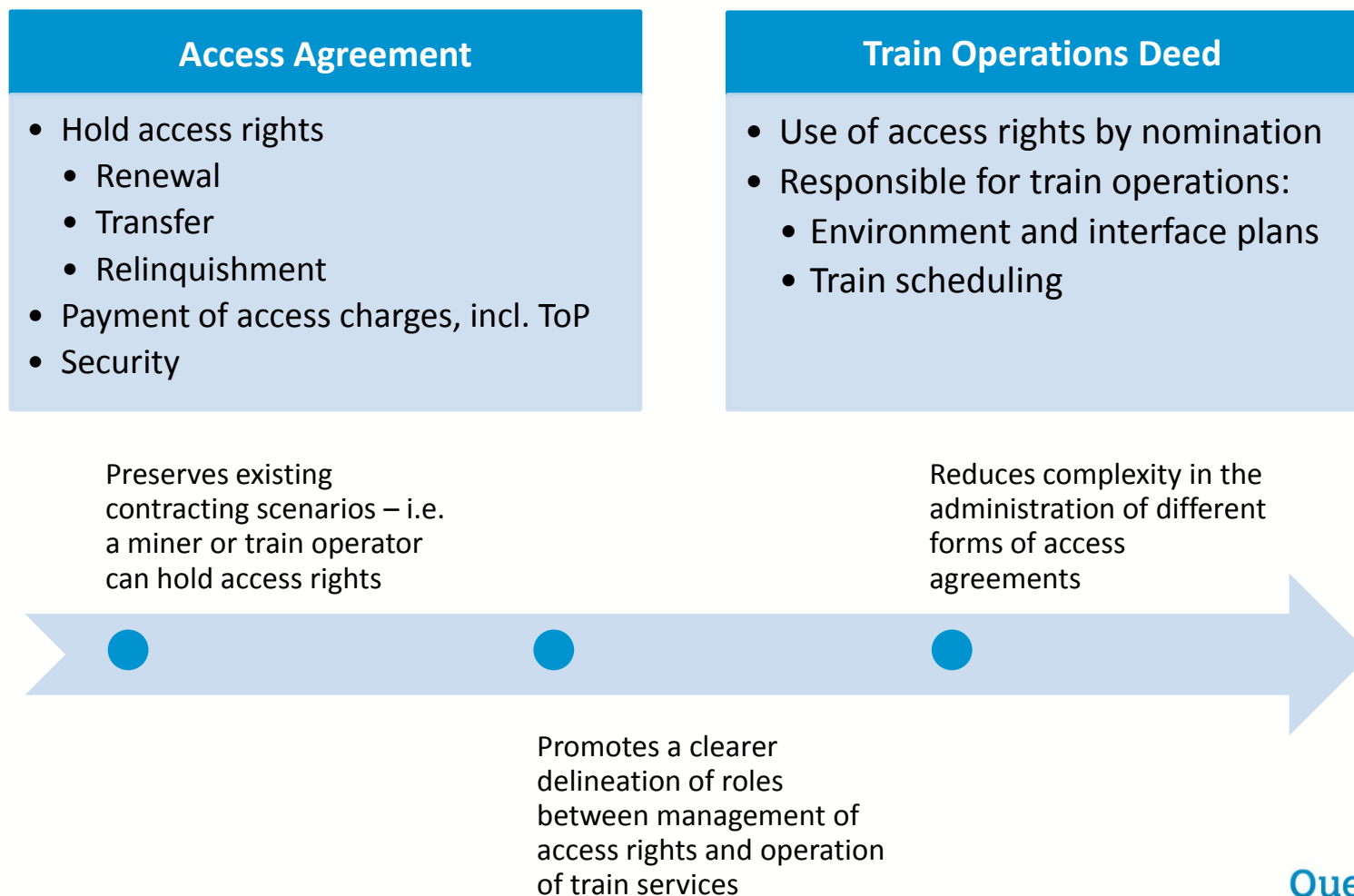
- so parties have sufficient information to make informed decisions
- incl. in relation to the nature and type of information AN can request and when information is to be made available.

## Promoting competition

- between above-rail operators tendering for rail haulage contracts
- incl. requiring AN to continue negotiating with all train operators during the negotiation phase until a nomination (by the access holder) is made.

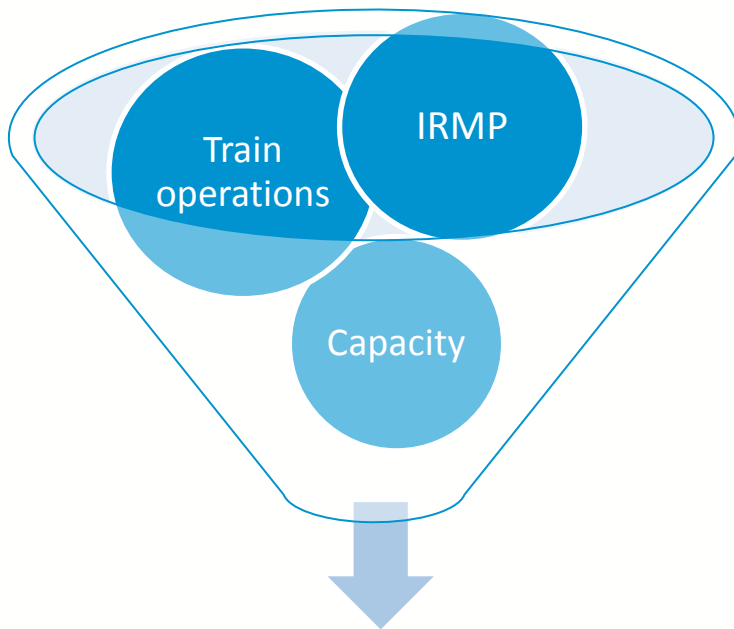
# Access agreements

We propose moving to a simpler approach for the SAAs:



# SAAAs – Simplification

## Matters moved back to the undertaking



### Required in the undertaking to ensure:

- consistency across access holders over time
- clarity and transparency
- dispute resolution outcomes applying to all.

## Stronger links to the undertaking

### Terms that update

Amendments to the undertaking automatically flow through to the access agreements:

- Transfer
- Relinquishment
- Reduction factor
- Conditional access
- Interface risk provisions
- Access charges

# SAA — Terms and Conditions

We have made changes to the terms and conditions to ensure they are workable and effective commercial agreements. These include amendments for:

## Certainty and security

- Accepted and clarified the introduction of *some* new terms, incl. supply chain rights and train service types.
- We have not accepted processes for changing payloads.
- No security required under the train operations deed.

## Better balance

- Commercially balanced and workable terms
- Rights and obligations of each party
- Risk profile between parties

## Streamline

- Clearer separation of roles (access rights v train operations)
- Reduced duplication
- Amendments to reduce complexity



# Connecting private infrastructure

Third parties are increasingly being required, and want the option, to develop and own private infrastructure to connect to the network.

We have focused on how arrangements will allow connections to the network to be designed and developed more quickly and with greater certainty for all parties.

## **We have proposed amendments to:**

- ensure there is an effective process for connecting private infrastructure, including minimising potential for unnecessary delays
- further develop the terms and conditions of the Standard Rail Connection Agreement (SRCA) to simplify and speed up negotiations for connections
- clarify the treatment of coal loss mitigation to ensure consistent application of the agreed industry standards and encourage best practice and to provide parties with greater certainty about their obligations.



# Capacity and Expansions

# Baseline capacity

A transparent and robust understanding of the capacity dynamics of the CQCN is necessary if the object of the third-party access regime in the QCA Act is to be achieved (section 69E of the QCA Act).

Efficient operation of, use of and investment in the CQCN

Participate in coal supply chain groups to maximise the performance of coal supply chains

Capacity waterfall of existing capacity, committed capacity and available capacity

Baseline capacity review

NMP, SOPs and System Rules and Day of Operations

# Baseline capacity (cont'd)

Aurizon Network's UT4 Proposal	Our Draft Decision
Aurizon Network to use reasonable endeavours to participate in supply chain groups	Aurizon Network to participate in supply chain groups in a non-discriminatory manner
Aurizon Network to conduct annual capacity reviews to determine the capacity rating of each coal system and the CQCN	Aurizon Network to submit a baseline capacity assessment to the QCA for approval within six months of the approval of the 2014 DAU
Aurizon Network will not contract any new access agreements that would increase the capacity deficit in any coal system	Aurizon Network to fund an expansion where it is prudent and efficient when there is capacity deficit
Aurizon Network to notify relevant access holders and supply chain groups of review of SOPs	Aurizon Network to submit the SOPs to the QCA for approval as part of the baseline capacity assessment
Aurizon Network to annually publish a NDP on its website	Aurizon Network's NDP to address specific information requirements

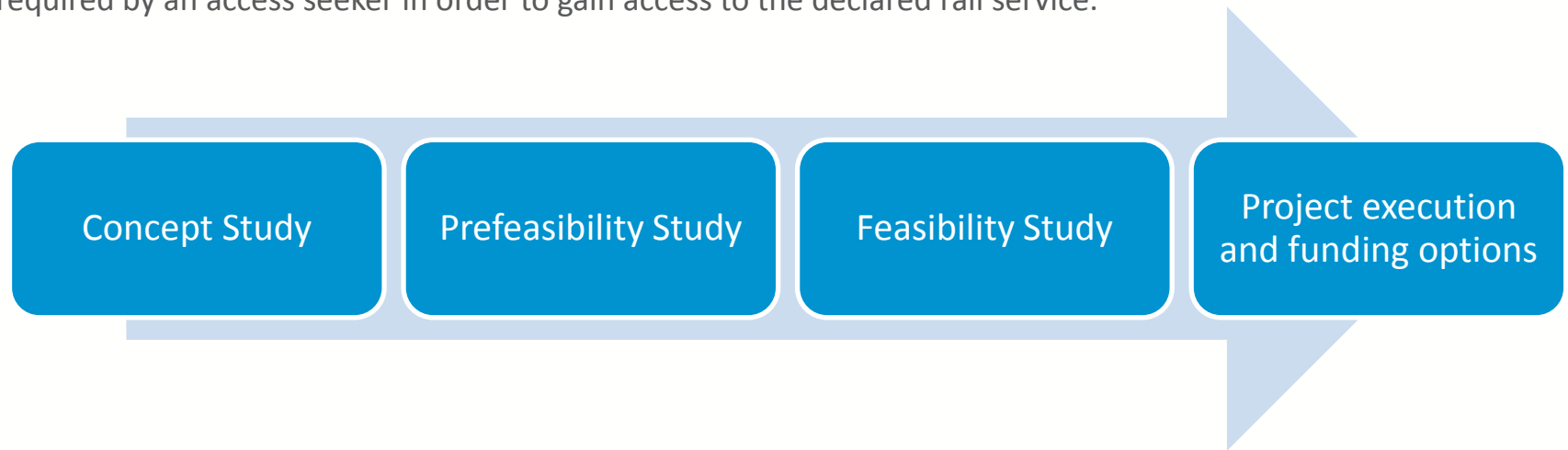


# Available capacity allocation and management

Aurizon Network's UT4 Proposal	Our Draft Decision
Use of capacity allocation criteria for available capacity allocation	Retain UT3 capacity queue
Move provisions from access undertaking into SAAs	Include provisions relating to resumptions, relinquishments and transfers in access undertaking <i>and</i> SAAs
Process for renewing access agreements	Retain majority of provisions from UT3
Streamline transfer process and include short term transfers	Query whether proposed and existing provisions allow for easy and timely transfer of access rights
Retention of access rights	Retain UT3 resumption provisions
Transfer and relinquishment fees	Increase transparency of calculation and query when a transfer fee should be applicable

# Network development and expansion

The QCA Act obliges Aurizon Network to extend the network or permit the extension of the network if it is required by an access seeker in order to gain access to the declared rail service.



A formal stage gate investment process must address:

- Aurizon Network's legitimate business interests
- an access seeker's information and demand requirements
- workable, bankable and credible funding options
- dispute resolution processes.

## Network development and expansion (cont'd)

Aurizon Network's UT4 Proposal	Our Draft Decision
Aurizon Network outlines its general obligations with respect to funding and constructing an expansion	Aurizon Network's general obligations have been streamlined and strengthened to meet the legitimate business interests of access seekers, customers and third-party financiers
Aurizon Network is obliged to promptly undertake pre-feasibility and feasibility studies where funded by customers	Aurizon Network's stage-gate process has been amended to address the legitimate business interests of access seekers and third-party financiers
Aurizon Network included a suite of SUFA agreements in the 2014 DAU	The 2014 DAU suite of SUFA agreements have been replaced by those applicable to the 2013 SUFA DAAU process
Aurizon Network provides conditional access rights with funders responsible for addressing any capacity shortfalls	Aurizon Network to provide an expansion capacity guarantee

# Network management principles

Our amendments to the NMP aim to improve transparency and accountability by:

- increasing transparency and availability of train plans (including a Strategic Train Plan and a Master Train Plan) and TSE-reconciliation reports, including requiring additional detail in the content of train plans and TSE-reconciliation reports
- setting timelines for Aurizon Network to submit train plans, aggregate TSE-reconciliation reports and initial system rules
- subjecting all system rules to QCA approval and ensure system rules are reviewed at least once per year.

# Regulatory asset base and customer voting

Aurizon Network recovers, through time, the value of the RAB (as indexed and adjusted) through the payment of access charges, including payments pursuant to take-or-pay obligations.

Against this background, it is important that only prudent and efficient investment in rail infrastructure should be included in the RAB. The regulatory framework should provide the correct incentives and credible sanctions so there is neither over-, nor under-investment in assets by Aurizon Network, user funders or third-party financiers.

We are proposing to significantly simplify the capital expenditure approval process and include a clearer process for regulatory pre-approval of projects. This will improve regulatory confidence for Aurizon Network, future user funders and financiers.

We are proposing customers should vote on a package of measures (i.e. scope, standard, and cost), not simply scope. This will enable the voters to make a more informed assessment of the project.

We have accepted Aurizon Network's proposal that equity raising costs should be recognised and included in the RAB, but will require Aurizon Network to show that its equity raising costs are efficient and necessary to support investment in the CQC.





## Pricing and Tariffs

# Pricing and legislative framework

Our assessment approach for 2014 DAU pricing has considered:

- whether prices recover efficient costs
- providing effective price signals for use of capacity
- providing appropriate signals for investment in infrastructure
- facilitating the ongoing development of the CQCN.

We believe that there may be some longer-term merit in considering the simplification of pricing structures and take-or-pay for the CQCN.

Our approach to the 2014 DAU has been to minimise unnecessary change for the UT4 period – given we consider there is a need to consider the longer-term pricing and take-or-pay arrangements.

# Pricing principles

## Price differentiation

- Provide for price differentiation only for cost or risk differences in providing access relative to the reference train (subject to the QCA's approval).

## Pricing limits

- Require the use of the RAB value for pricing in all circumstances, except where it is unavailable.

## Commercial terms

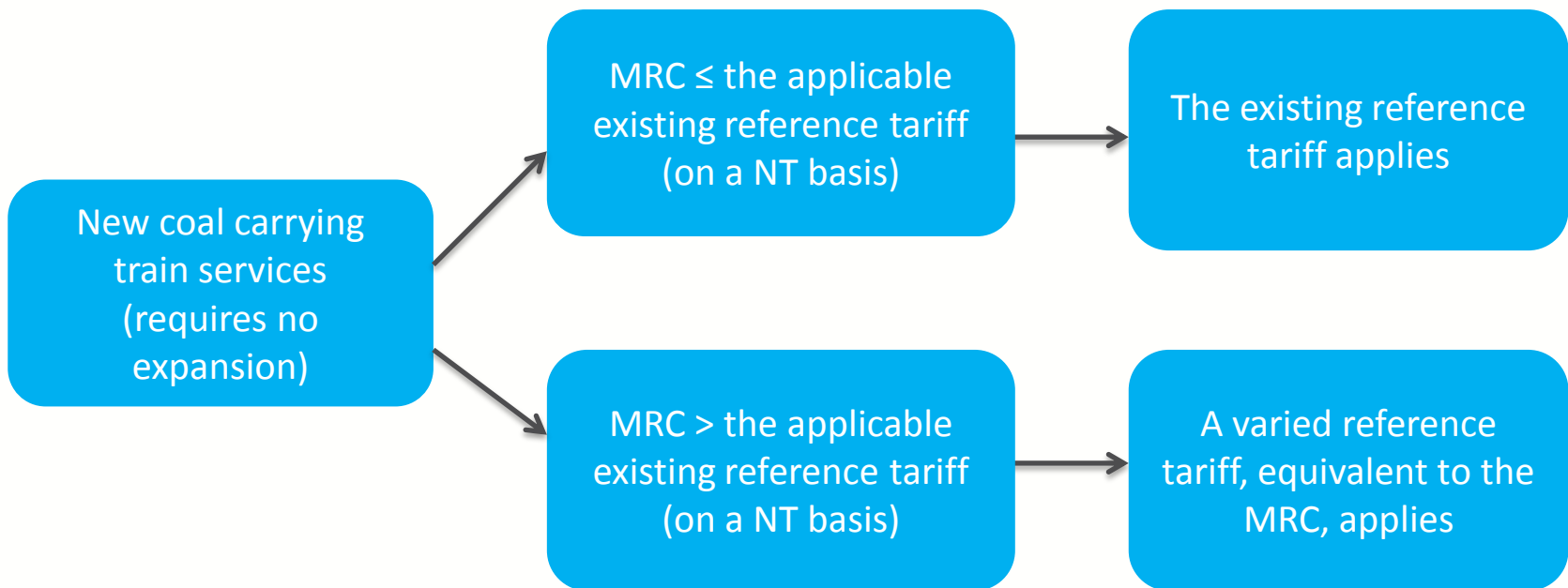
- Remove commercial terms and reinstate and refine the UT3 access condition provisions—additional terms of access to mitigate Aurizon Network's costs or risks are subject to the QCA's approval.

# Expansion pricing

- The 2014 DAU includes, for the first time, a clear process for setting expansion tariffs. Aurizon Network has worked with its stakeholders to develop the expansion tariff process.
- The expansion tariff process is intended to provide greater certainty about the likely pricing arrangements prior to a project commencing.
- Our draft decision reflects that a **separate** expansion tariff, based on **contracted volumes**, will be established if an expansion is triggered—to isolate the financial risks of expansions from existing users.
- Implement a **‘fixed-cost’** regime (stronger take-or-pay) for users paying an expansion tariff—AT2 to AT4 tariffs, AT5 if electric infrastructure is involved, will not vary with actual usage, except for Aurizon Network Cause.
- If there is an existing expansion tariff and another expansion is triggered, we will consider socialisation between the two in accordance with our approved socialisation test.

# Pricing new coal carrying train services

For projects which are not subject to the expansion tariff process, our Draft Decision is to refine Aurizon Network's proposed Minimum Revenue Contribution (MRC) to address issues of the UT3 approach, but refuse to approve the Distance Discount concept.

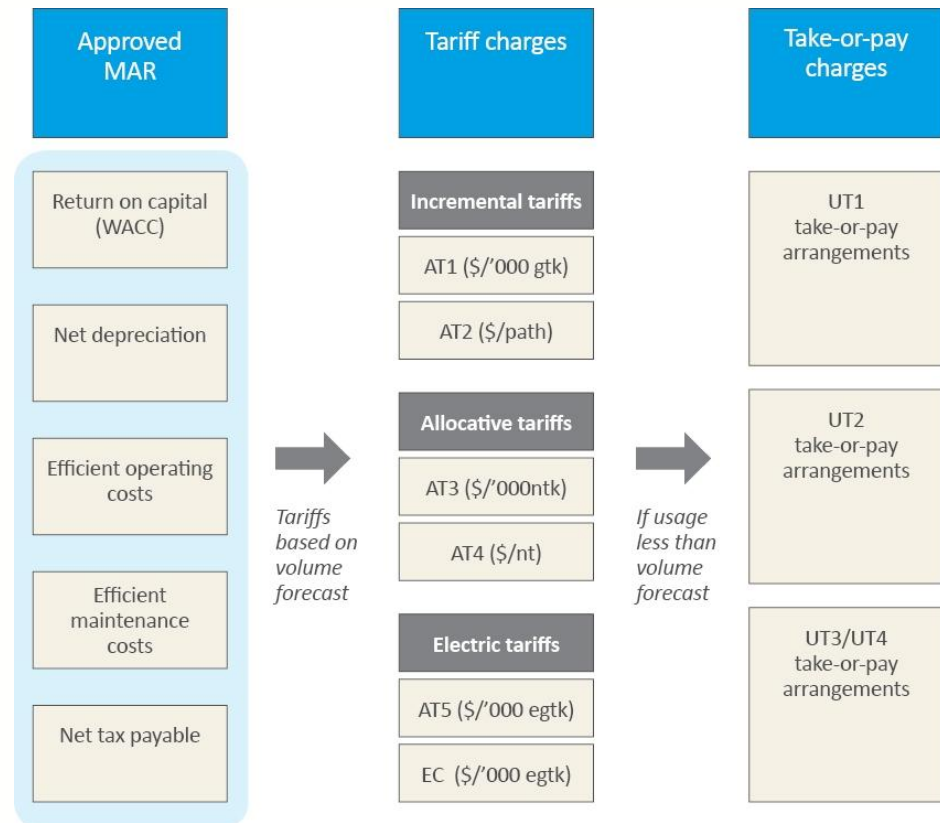




# Reference tariffs

- The MAR forms the basis for calculating reference tariffs contained in Schedule F of the 2014 DAU.
- The existing tariff arrangements have been in place since UT1 and have been adapted through time as new issues arise, progressively becoming more complex.
- We are of the view that the existing pricing structure is overdue for review and potential simplification.
- Some of Aurizon Network's proposed changes appear to add further complexity to existing pricing arrangements:
  - Rebalancing of tariff structure (↑ AT2 incremental capacity tariff)
  - Changes to AT1 incremental maintenance tariff arrangements
  - Take-or-pay capping mechanisms (e.g. operator capping)

## Relationship between the approved MAR, tariffs and take-or-pay charges



# Reference tariffs (cont'd)

Aurizon Network's UT4 Proposal	Our Draft Decision
Rebalancing of tariff structure with material rises in incremental capacity tariff (AT2)	We have not accepted this proposal – and will retain the arrangement from the 2010 AU
Changes to arrangements for the incremental maintenance tariff (AT1) to minimise revenue variability	We have not accepted the proposal for a maintenance cost adjustment and to include AT1 revenue in the revenue cap – and will retain the arrangements from the 2010 AU
Reference tariffs for new train services	Reference tariffs for Middlemount and Caval Ridge based on pricing principles in place at commencement of operations
GAPE pricing arrangements	We have refused to accept Aurizon Network's proposed socialisation of NAPE costs within the Newlands system
Wiggins Island Rail Project pricing arrangements	Given the significance and materiality of WIRP pricing issues, we are treating WIRP as a separate process

# Take-or-pay arrangements

There are differences in take-or-pay arrangements across access holders depending on when particular access agreements were executed. This introduces potential inequities across different access holders.

Take-or-pay arrangements provide a proxy for the holding cost of capacity. Simplification of these arrangements would complement a flexible trading mechanism. We consider there are benefits to Aurizon Network developing proposals for UT5 to simplify and harmonise take-or-pay arrangements.

Aurizon Network's UT4 Proposal	Our Draft Decision
Special arrangements for UT1 access holders	We are not convinced of the need to provide separate take-or-pay arrangements for holders of UT1 access agreements.
Introduction of operator capping provisions	We consider that a flexible trading mechanism is a more appropriate approach to managing take-or-pay liabilities and promoting efficient capacity use.



## Definition & Glossary

# Significant definition changes

We propose a series of changes to definitions

- Some minor points of clarification, some more substantive
- Among most substantive are those relating to:

Definition	Reason
Access Agreements and SAAs	To support our simplified SAAs
Commercial terms	Replaced with Access Conditions (incl. an approval process)
Access Holder/ Seeker	To ensure Train Operators are included
Expansion process studies (concept, feasibility, pre-feasibility)	To clearly set out procedures and outputs to ensure studies are prepared to a level fit-for-purpose
Aurizon Network Cause	Based on principle 'cause' should rest with party with control
Capacity (and related terms)	To support our proposals for allocating and expanding capacity
System Rules	To clarify content and processes for development
Related Competitors	New definition to cover ports and coal mines that Aurizon Holdings has an interest in
Queue	New definition to restore the queuing mechanism to the 2014 DAU



# Submission and Indicative Timetable

We are seeking views from interested parties on this Draft Decision.

**Submissions are due by 17 April 2015.**

We will consider all submissions received in making our final decision.

Task	Indicative Date
Submissions on 2014 DAU Draft Decision	17 April 2015
2013 SUFA DAAU Final Decision	30 April 2015
2014 DAU Final Decision	31 July 2015
UT4 Commences	September 2015