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SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY

SUBMISSION IN RESPONSE TO THE QCA DRAFT DECISION ON THE AURIZON NETWORK 2017 DAU

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1. INTRODUCTION

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

Capitalised terms in this submission have the meaning given to them in the DAU.

SUPPORT FOR QCA DRAFT DECISION

While there are elements that do not reflect Anglo American view of the ideal or appropriate outcome on individual issues, it would be willing to accept the QCA's Draft Decision as an appropriate package in aggregate, except as set out in this submission.

2. SUPPORT FOR QRC SUBMISSION

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, generally supports the QRC submission in respect of the UT5 DAU, except as expressly set out in this submission. Anglo American is otherwise willing to provide confidential information to assist the QCA in arriving at reliable system volume forecasts.

3. AURIZON'S RECENT STATEMENTS ON MAINTENANCE AND CAPACITY

Anglo American (like all other participants in the coal chain) remains considerably disappointed in Aurizon Network's response to the QCA's Draft Decision, particularly under a negotiate/arbitrate model which enables sensible and reliable positions to be understood and put before the regulator.

It is critical that the QCA is not swayed by such conduct and continues to fulfil its statutory obligation to only approve a draft access undertaking it considers appropriate based on reliably provided and analysed information to reach informed conclusions.

Anglo American supports the QCA draft decision on pricing matters, including maintenance and operational expenditure allowances (dealt with further below) except as expressly set out in the QRC submission and this submission. Of note is the QCA’s approach to the WACC, in particular, which is commensurate with the extremely limited risk Aurizon Network faces and the protection afforded under the revenue cap regime as recently evidenced during the export coal market downturn. Aurizon Network’s proposed modifications in that regard are inappropriate in the circumstances, particularly given Aurizon was privatised with the current regime and approach in place.

Drastic changes in approach like those suggested by Aurizon Network are also contrary to the need for regulatory certainty (which is critical in the context of coal producers and haulage operators making long term investment decisions on the implicit assumption that the QCA's general approach will continue).

The recent Aurizon Network statements and behaviours also raise the question of whether there needs to be adjustments to the revenue cap form of regulation if Aurizon Network is electing to operate the network in an inefficient manner that reduces capacity of the network. In that regard, Anglo American strongly supports the QRC's view that it should not be the case that Aurizon Network can unilaterally reduce the ability of access holders to access the network or any information about that without any adverse commercial impact on the maximum allowable revenue including returns.

As a result, Anglo American considers that it would be appropriate for revenue adjustments of the nature proposed by the QRC to take effect if it is evident that Aurizon Network is reducing the capacity of the network as the public statements of Aurizon indicate.

4. WIRP DEFERRALS

Anglo American notes that the QCA has specifically sought stakeholders' views on the position regarding the WIRP revenue deferrals.

Anglo American is an 'Existing Moura' customer (using the terminology on page 8 of the Draft Decision), as a customer with a mine located in the Moura System, but who has not contracted any train services under the WIRP arrangements.

Anglo American supports the QCA's draft position on Moura WIRP deferrals remaining in place.

Consistent with Anglo American's initial submissions, it is noted that:

- There is no clearly established basis for the relevant deferred revenue tonnes coming on line (at least in respect of the Moura system);
- 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 such as Anglo American, and sought commercial consideration (in additional to the revenue derived from the regulatory arrangements) to undertake the project and any related risks.

That is, while Anglo American supports the deferrals, it continues to consider that if the deferrals cease in the future, it should not be assumed the costs should simply be socialised among all users in the system at the time.

Anglo American's views on how expansions ought to be priced is the same as expressed in UT4 (addressed further below) and remains strongly opposed to cross default risk for expansion projects being borne by existing users, which were 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 addition, the nature of the WIRP expansion in the Moura system is such that it is understood to be WIRP user specific. Therefore, should not be paid for by an existing Moura (non WIRP) user in circumstances particularly where there is no real benefit for them resulting from what was a WIRP specific related expansion. Any expansions, or part(s) thereof, that are discrete or involving works that are origin and/or destination specific should not be paid for by users obtaining no real benefit from the project. This approach is also not inconsistent with the system premium concept.

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 and related cross default risk with other users, whether they be either WIRP project participants or more importantly Non-WIRP users.

5. FORECAST CAPITAL EXPENDITURE

Anglo American notes that the QCA has specifically sought stakeholders' views on the position on forecast capital expenditure.

The Draft Decision indicates that the QCA is minded to switch from an ex post annual assessment process to an incentive-based ex ante process for renewal capital expenditure. The rationale for this is summarised as being 'to provide greater certainty and an incentive framework for Aurizon Network'. A more robust capital approvals process is required.

While Anglo American appreciates the proposal is well intentioned, it is concerned that it could produce unintended adverse consequences. In particular, such a system is likely to:

- create incentives for Aurizon Network to inflate cost estimates when the renewals budget is being set; and

- deliver renewal capital projects to a lower standard or reduced scope from that on which the renewals budget was based.

Anglo American expressed its concerns in it is initial submission about the lack of detail around the forecast renewals expenditures over the UT5 period, and is concerned that this switch in approach will exacerbate the issues arising from this lack of detail, and is being proposed without any guarantee that greater information will be available so that the budget can be approved as reflecting the efficient costs with greater certainty than is currently the case.

Anglo American acknowledges that a bottom-up build up can be costly – but it cannot be appropriate to allow Aurizon Network to levy access charges based on an inefficient regulatory asset base merely because it is easier.

Ex-post annual assessment at the very least ensures that each capital item is reviewed to ensure it was prudent and efficient. As noted in the Draft Decision, 'Aurizon Network therefore has an incentive to ensure that its capital expenditures meet the required prudency of scope and efficiency of standard and cost' (page 46). This seems far more likely to Anglo American to promote the object of efficient investment in infrastructure than the proposed model absent reliable information and a transparent capital approvals process.

Anglo American also continues to note the benefits which would be derived from an equivalent of the 'Rail Capacity Group' (***RCG***) which exists in relation to ARTC's Hunter Valley rail network. The proposed Capital Indicator to apply for each system during each Undertaking period could first be presented and then endorsed by a proposed 'Rail Capacity Group' or equivalent made up of the appropriate users of each system, to review and support all capital expenditure allowances and monitor projects as part of the Investment Framework subsequently presented to the QCA by Aurizon Network for approval. This would enable a more streamlined regulatory approval process. Aurizon Network can still secure regulatory approval under the relevant criteria, as does ARTC, if the 'RCG' does not support any aspects of the claim.

Anglo American strongly considers the introduction of such a group should be considered irrespective of the approach to renewals expenditure – and would do far more to improve the efficiency of capital investment through driving transparency and facilitating Aurizon Network gaining greater input from stakeholders. However, this change is critical if the initial capital expenditure is going to be heavily relied on as an accurate assessment of efficient cost as would be necessary in an ex-ante process.

Anglo American therefore submits that it is a necessary precursor to the switch to an ex-ante process during post UT5 regulatory periods, to introduce a rail capacity group as part of UT5 (which will then be able to properly inform the assessment of the initial capital indicator for the UT6 period).

6. OPEX AND MAINTENANCE ALLOWANCES

As noted above, Anglo American considers Aurizon's public statements and activities regarding maintenance allowances and impact on capacity should not influence the QCA's assessment of what constitutes an appropriate allowance. If Aurizon Network can genuinely justify the efficiency of its claimed allowances, then it should presumably be able to do that in submissions in the normal way, rather than seeking to hold the regulatory process, the QCA, haulage operators and coal producers ‘hostage’. To the extent that Aurizon Network does provide further detail, then Anglo American would support and anticipate the QCA conducting a thorough review of the prudency and efficiency of any revised allowance claimed. It is noted that any impacts on the final MAR and in the first year of the regulatory period would be recoverable by Aurizon Network over the balance of the UT5 period under the revenue cap.

Anglo American also notes that the QCA's decisions do not mandate or prescribe particular operating or maintenance practices (as Aurizon has claimed publicly), rather they set an allowance (and in this case, different approaches) reflective of efficient cost and that provides Aurizon Network appropriate incentives to reduce its costs to that level to the extent its costs are greater than that through existing (and long term) inefficient practices.

Anglo American specifically notes its support for the points the QRC raises in relation to the allocation of costs and calculation of these allowances, and reiterates the issues raised in Anglo American's own initial submission. Stakeholders like Anglo American, who do not have access to the same extent of information as the QCA and its expert advisors, are heavily reliant on the QCA's assessment of the efficiency and prudency of the allowances proposed and to ensure it has been provided with sufficient information to make an informed determination of appropriate cost allocations.

In particular, Anglo American continues to consider that simply escalating from UT4 costs (which occurred in a different economic and cost environment) is not an appropriately methodology for assessing appropriate operating and maintenance cost allowances. Anglo American is not uncomfortable however with the proposed approach of locking in a base year, provided it is appropriate and sufficiently robust, from which to provide an effective platform to drive efficiency improvements.

Anglo American also supports the introduction of an efficiency target as proposed in the Draft Decision. Ideally it should be set higher (and less conservatively) than the 2% which the QCA has adopted (given the 3% rate determined to be achievable by the QCA's advisers), and it should start as soon as practicable rather than being delayed. It has been clearly foreshadowed to Aurizon Network in the Draft Decision that it is considered that its costs are inefficient (and Aurizon Network's recent statements such that Aurizon Network itself considers it is possible for it to rapidly change its approach to operations and maintenance).

7. INCENTIVISING OPERATIONAL IMPROVEMENTS

Anglo American notes that the QCA has specifically sought stakeholders' views on its proposals in Chapter 17 of the Draft Decision in relation to incentivising Aurizon Network to make operational improvement to avoid unnecessary investments, and ways in which efficiency gains might be fairly shared while presenting Aurizon Network with effective and balanced incentives.

Anglo American is genuinely concerned that Aurizon's recent conduct, coupled with the proposed weakening of the obligations to be involved in supply chain groups, demonstrates that Aurizon Network does not have appropriate incentives to make operational improvements (or assist and accept suggestions from supply chain groups for such improvements). The current behaviour is particularly concerning where Aurizon Network has stated publicly and intentionally chooses to withhold information from stakeholders, such as users and supply chain groups, creating immediate and future operational impacts.

As recognised in the Draft Decision (page 391), 'The costs of operational changes that result in an increase in capacity should be compared to the costs of comparable infrastructure expansion options. The supply chain groups may be able to propose cost-effective changes that defer capacity expansions'. This applies not only in the medium to long term but also short term operational environment where such impacts are immediate including withholding information affecting accurate forecasting, planning & scheduling and contracting uncertainty.

At the very least, establishment of a rail capacity group for each Aurizon Network system (i.e. Moura, Goonyella, Blackwater, Newlands) along with increased, more transparent and reliable reporting (or information provision) requirements (incl maintenance) should be considered if such supply chain obligations are to be weakened. This should not place any additional undue burden or cost on Aurizon Network other than to make their current resources (ie -relevant systems and people) more accessible. In the current environment, it is unclear what level of declared service is actually available or being provided.

Consistent with its initial submission, Anglo American considers that a form of price cap regulation, under an appropriate regime, is more likely to incentivise Aurizon Network to increase efficiency on the network as the decreased costs would be seen as increased margins. A price cap form of regulation would also reduce Aurizon Network's incentive to overcapitalise on its investment in the network (in contrast to the current system where a capital solution results in an increase in the RAB and additional revenue while Aurizon Network perceives operational improvements as simply being a reduction in its cost allowances or an undesirable alternative to capital projects given the opportunity to increase returns).

8. ISSUES THAT HAVE BECOME EVIDENT IN UT4

Anglo American detailed in its initial submissions a concern that UT4 had been in place for insufficient time to be effectively deeming UT4 (or UT4 aspects) to be appropriate (in UT5). In particular, Anglo American notes the following issues which have developed since the approval of UT4 which have become appropriate to address in the context of UT5:

Network Management Principles & System Rules

Train Planning – Effectiveness of the ITP

The current train planning arrangements (contained in Schedule G of the access undertaking and related documents such as System Rules, as defined) are extremely rigid and designed around Aurizon Network's legacy approach to planning, scheduling and providing access to the declared service rather than efficiency and flexibility.

The ITP as a fixed weekly plan is a clear example, which makes it difficult to remain flexible in dealing with issues which arise leading up to the delivery of the schedule in the rolling 96hr and 'day of ops'.

Under the ITP process a 'schedule' of train paths is presented to the port provider at 1600 on Thursday afternoon for acknowledgement and implementation requiring realignment of the berthing and rail delivery windows from the earlier requested orders to meet the ITP for the following week.

Following this, Aurizon Network develops the rolling 96 hour rail schedule whereby it advises the finalised train schedule and pathing plan for trains, in the case of Goonyella by way of example, departing Jilalan in the >24 to 96 hour period. This then forms the

Daily Train Plan (including detail around connections between the train paths in the ITP and the unload slots at the terminal, departure and arrival times, planned dwells etc) which rolls across a 96 hour period with a day being added to the rolling 96 hour schedule every 24 hours within the ITP. This process starts again the following week for the week after.

Due to decisions in the intervening period being made around connections and continual variation, services lost in the 'day of ops' cannot generally be recovered in the 96 hour period. Further adjustments and additional variation to ensure critical trains are delivered to complete parcels and meet berthing times is required. Little can be done by terminal operators to influence this rolling 96 hour process other than modify the schedule as advised based on train and network availability.

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, including 'campaign' railing and greater need for peaking requirements as well as greater flexibility in the ability for recovery to plan.

It is proposed that this be reviewed and that a rolling 7 day plan, whilst maintaining the 96hr rolling schedule, be considered. This would enable better recovery by allowing losses to be pushed into the 8th day for example creating more flexibility and mitigating operational variation.

System Availability

From a Network level, System Availability is understood to be determined by taking the total theoretical capacity and deducting a proportion, namely 15%, for maintenance and renewals. A further 30% is then allowed for variations to maintenance and renewals as well as reliability issues, unplanned events, operational system losses, etc which is understood to then represent average utilisation. Using such an approach, there appears to be more than sufficient buffer capacity to enable Aurizon Network to meet its asset protection and capacity obligations.

In the planning and scheduling environment, it is understood that Network also then schedules and allocates paths during maintenance periods, even planned maintenance, on a pro rata basis in the weekly environment.

Because pathing and system availability is solely referenced by an available path into the port – opportunities are being missed to schedule train journeys more efficiently.

Pathing availability needs to be determined by reference to Train Service Entitlements (***TSEs***) in both directions (i.e. mine load out to terminal and back), and determined across the entire system not just for duplicated sections as is understood to be the current practice.

Further, reporting 'system availability' on this basis is inflated and inaccurate being based on pathing in the duplicated section of the system only into a port inloading slot. This does not reflect true 'system' availability and is an unreliable reporting metric as it ignores any branch lines which need to be traversed to make the connection to the duplicated section, of which there are only so many 'loaded' journeys into the port slot. Further, a rail operator will not plan the loaded journey if it cannot be confident of securing the return 'empty' journey back to the mine if required or provisioning facilities, etc. This is also not captured in the system availability reporting metric and for all mines using sharing various branch lines of that system (incl cross system traffic). As TSEs are one way and contracted as such by origin/destination, true system availability is not being delivered or reported, and therefore measured, relative to contract or actual 'system' availability on a given day or in the weekly planning and scheduling environment.

The recent statements by Aurizon about implementing changes in maintenance practices resulting in a loss of capacity, have demonstrated once again the difficulty users currently experience in obtaining transparency of real system availability or contract performance.

Anglo American supports the QCA's request for key operation and maintenance activities to be reported monthly by system to all access holders, and reporting on train paths not scheduled because of Aurizon Network's acts or omissions, including maintenance.

The lack of this sort of reporting is hindering efficient coal supply chain planning and scheduling (thereby reducing operational efficiency), and complicating effective contracting of haulage and port and track access agreements amongst other things.

Multiplier – capacity vs diesel

It is understood that although the diesel multiplier was abandoned in UT4, it appears that Aurizon Network may continue to be applying the capacity multiplier to diesel services in electrified systems without any meaningful explanation. If that is the case, that would result in Aurizon Network charging a higher fixed charge per train path without any justification for doing so. Anglo American requests the QCA investigates whether this is in fact occurring.

Electric Traction - AT5

The electric traction component of reference tariffs (AT5) have been a continuing source of contention through the UT4 regulatory period. Please refer to the QRC's submission on that issue as made in the various AT5 related draft amending access undertaking submissions and take them into account in relation to the treatment of this issue in UT5.

User Funding Arrangements

The fact that Aurizon Network has been able to simply withdraw from development of a Standard User Funding Agreement is a travesty. This has been a long running issue since Aurizon Network availed itself of its monopoly position under UT2 to use economic hold up as a tool to then earn an above regulated return for the GAPE project. That was followed by similar conduct in relation to the WIRP project under UT3. The issues now being caused by the WIRP deferrals indicate the difficulties caused by this approach.

The Reference Use Funding Agreement that has been uploaded to the Aurizon Network website is unbalanced and inappropriate, as is evident immediately when you compare the QCA's reasoning in its consideration of earlier SUFA iterations to what Aurizon Network is now proposing. It is also completely outside the regulatory framework and can simply be withdrawn if it no longer suits Aurizon Network.

The QCA should ensure that UT5 provides obligations to resolve this issue.