



Mr Linus Power MP
Chair
Economics and Governance Committee
Parliament House
George Street
BRISBANE QLD 4000

28 February 2018

Dear Mr Power

I am writing on behalf of Aurizon Network Pty Ltd (**Aurizon Network**) regarding the *Queensland Competition Authority Amendment Bill 2018 (Bill)* which is before the Economics and Governance Committee for consideration.

We appreciate the opportunity to provide a submission to the Committee in relation to the Bill.

Aurizon Network has significant concerns about the effect that the changes proposed in the Bill will have, both on businesses that are subject to regulation, like Aurizon Network and Queensland Rail, and on our ability and the ability of others to invest further in maintaining and improving our rail infrastructure network and the jobs that go with it.

The proposed changes may seem innocuous, but their negative effect on investment in large-scale infrastructure like the Central Queensland Coal Network (**CQCN**) could be significant.

As you would be aware, Aurizon Network provides rail access to the coal industry in the CQCN. In 2016 -17 Queensland's coal sector generated \$36.2 billion in export revenue, an estimated 30,925 jobs for the State, and delivered \$ 3.4 billion in royalty payments to the Queensland Government. None of that would have been possible without the rail access services provided by Aurizon Network, which last year shipped 211mtpa for export from more than 40 mines to 5 port terminals in Queensland.

What the QCA Act says now

Aurizon Network's rail access service is regulated, including as to price, by the Queensland Competition Authority (**QCA**) under the terms of the *Queensland Competition Authority Act 1997 (QCA Act)*.

The QCA Act effectively dictates what the QCA must do and must take into account when it regulates the services offered by access providers like Aurizon Network.

Currently, one of the key matters that the QCA must ensure is that the price it sets for access is enough to:

“...generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved” – section 168A.

In other words, the price for access set by the QCA must be at least enough to allow access providers like Aurizon Network to recover their efficient costs and to make a return on their investment that reflects the risks they take in providing the declared service.

The obligation on the QCA to ensure that outcome is found in what is described in the QCA Act as a ‘pricing principle’, which forms a cornerstone of the access regime. The importance of the pricing principle is emphasised by, and consistent with, the stated objects of the access regime in QCA Act, namely:

“...to promote the economically efficient operation, and use of and investment in, significant infrastructure by which services are provided, with the effect of promoting competition in upstream and downstream markets” – section 69E

This is supported by the Productivity Commission’s Inquiry Report into the national access regime in 2001, which was instrumental in developing the pricing principles included within the national access regime. In that report the Productivity Commission said that:

“... the Commission considers that there is a need for pricing principles within an access regime’s architecture to underscore all determinations made under that regime. Indeed, pricing guidelines are an important vehicle for giving effect to the objectives of access regulation..... The first principle [i.e. the equivalent of s168A(a) of the Queensland regime] set a relatively clear floor to revenue allowed within an access regime to facilitate investment in the essential service (without necessarily constraining individual prices).”

It is therefore important in meeting the objects of the access regime in the QCA Act to promote competition and efficient investment in the CQCN that the pricing principle in section 168A is reflected, and given effect to, by the QCA when it makes pricing decisions.

If infrastructure access providers and their shareholders and investors cannot be sure that the access provider will at least recover its efficient costs and an appropriate return for the risks of providing the service, that lack of certainty will have a genuine negative impact on their willingness and ability to invest in the infrastructure. Investors need certainty, particularly when making long-term investments in large-scale infrastructure like rail networks.

If the outcomes of regulatory processes deter infrastructure investment by not providing for a return commensurate with the risks involved, this is likely to compromise the ability of the operator to continue to maintain a network that efficiently provides infrastructure services to customers. Such a risk to maintaining efficient infrastructure services is likely to have a negative impact on customers in the form of reduced investment, job losses and reduced royalties provided by the coal industry. These negative impacts are likely to be substantial due to the fact that Queensland’s coal exporters are selling their products into highly competitive global markets. They therefore rely on Aurizon Network having the ability to invest in and maintain a high performing and efficient rail network.

What's the proposed change and why?

The key way in which the QCA regulates rail and other infrastructure access, and the businesses that provide it, is through the process for approval of regular access undertakings. These are in effect QCA approved undertakings that set the price and other terms on which access providers will deal with anyone like mining companies, for example, that wish to access their infrastructure. It is in the approval process for these undertakings that the QCA currently must ensure the pricing principle is met.

In recent times, the QCA has made regulatory decisions that have advanced the QCA's view that it should not be bound to ensure that the pricing principle is met and that the pricing principle is merely something the QCA "should have regard to". This approach has led to significant actual and proposed declines in the allowable revenue that access providers are being permitted to earn.

For example, in the current UT5 regulatory process in which Aurizon Network is involved, covering the period from 1 July 2017 to 30 June 2021, the QCA issued a draft decision on 15 December 2017 (**Draft Decision**) which proposes a maximum allowable revenue for Aurizon Network which is approximately \$1 billion less than what Aurizon Network assessed as being adequate to meet its investment, maintenance and operational requirements. This is similar in dollar terms to the allowance approved by the QCA under the previous UT4 regulatory process just over a year ago in October 2016, despite the QCA forecasting volumes for the UT5 regulatory period that are 130 million tonnes, or circa 15%, higher in aggregate over four years than current volumes, and recognising an asset base which is worth approximately \$1 billion more than it was at the commencement of the UT4 regulatory period. The rate of return proposed by the QCA for Aurizon Network is only 5.41% - a rate that fails to recognise the risks and complexities of operating the rail network in central Queensland.

Despite the QCA Act requiring the QCA to have regard to the pricing principles (including the principle set out above), the Draft Decision demonstrates the QCA is already willing to make pricing decisions that amount to a return to Aurizon Network that is below the efficient cost of providing the services we provide. The Draft Decision reveals that the QCA is prepared to restrict Aurizon Network to a non-commercial rate of return.

Aurizon Network is currently taking issue with that and other aspects of the Draft Decision. Similarly, in the past, Aurizon Network and other access providers like Queensland Rail have taken issue with regulatory decisions in which the QCA has indicated that it does not feel itself to be bound to ensure that access providers receive at least their efficient costs and an appropriate return, as required by the pricing principle and the objects of the access provisions as set out in Part 5 of the QCA Act.

It is against the background of these submissions to the QCA, pointing out its statutory obligation to give life to the pricing principle, and the risk of judicial review should the QCA fail to do so, that the process to have the QCA Act changed in the way proposed in the Bill has been instigated.

The specific changes proposed in the Bill are designed to make clear that, contrary to the current position, the QCA will not be bound to ensure that access providers obtain at least their efficient costs and an appropriate return having regard to the regulatory and commercial risks of providing the declared service. Instead, the Bill, if passed, will only oblige the QCA to "have regard" to the pricing principle along with a list of other matters that the QCA must have regard to when making decisions about approving access undertakings. Indeed, the Explanatory Note expressly states that "*the Authority is not required to satisfy each pricing principle in deciding whether to approve a draft access undertaking or make an access determination.*"

In other words, the QCA is seeking to ensure it has an enshrined discretion to drive the price for access below what would give access providers at least their efficient costs of providing the service and a return. It is that largely unfettered discretion that creates the uncertainty that will impact in a material way on access providers, shareholders and investors when deciding whether or not to further invest in maintaining, enhancing and expanding large-scale infrastructure.

What is Aurizon Network seeking from the Committee?

Before answering that question we should make clear that whatever change might be made to the law by the Bill, it will have no effect on the current UT5 regulatory process underway in respect of the Aurizon Network's access undertaking covering the period from 1 July 2017 to 30 June 2021. The current law will apply to that process regardless. The Bill will only affect future decisions (as specific transitional provisions have been included within the Bill to this effect).

Aurizon Network's request is for the Committee to recommend against making the proposed changes. As indicated above, while on the surface the proposed changes seem innocuous, they have very far-reaching consequences for all the reasons, and in the ways discussed in this letter.

It is also important to mention two other factors that the Committee should take into account when considering this issue:

Firstly, the QCA has indicated in its past regulatory decisions and in seeking the proposed changes that, even under the current law, it does not consider itself bound to give the pricing principle any priority over other factors to which it must have regard. If that is correct, it begs the question, 'Why are the changes needed?'

Secondly, and importantly, when the pricing principle was first introduced into the QCA Act, the Explanatory Notes reveal that Parliament intended the pricing principle to provide "overriding guidance" to the QCA in its decision-making on the content and effect of access undertakings.

We can see no change in circumstances or other factor, and none have been pointed to by the QCA, that would justify the removal of protection for the pricing principle. This is particularly so where the Queensland Parliament has already expressly stated that the pricing principle should operate to provide "overriding guidance" to the QCA.

Explanatory Notes

If despite the matters raised in this letter, the Committee is still minded to recommend in favour of the proposed changes, Aurizon Network requests that at very least, the Committee also recommend that the Explanatory Notes for the Bill be amended.

In that regard, the Explanatory Notes should expressly confirm that, notwithstanding the amendments and consistent with the intent of Parliament at the time of introducing the pricing principles to the QCA Act, the pricing principles are to continue to provide overriding guidance to the QCA, with departures to be limited to those exceptional cases where there is demonstrated, genuine economic justification and a lack of prejudice to the objects of Part 5 of the QCA Act. This is less beneficial and certain than the current position, but at least will help ensure the QCA understands that it must apply some additional critical analysis before dismissing the pricing principle in favour of other factors it prefers.

Other proposed changes in the Bill

Aurizon Network supports the sets of amendments proposed in the Bill in relation to changes to the declaration criteria and the QCA timelines.

Conclusion

Thank you for considering this letter. We would be happy to present before the Committee to discuss our concerns. In the meantime, we enclose more detailed submissions on our concerns in relation the proposed change in the Bill affecting the application of the pricing principle.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D Collins', with a long horizontal flourish extending to the right.

David Collins
A/Group Executive Network



Aurizon Network

Submission in Response to the Queensland Competition Authority Act Amendment Bill 2018

28 February 2018



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Introduction

- 1 Thank you for the opportunity to comment on the Queensland Competition Authority Amendment Bill 2018 (**Bill**).
- 2 There are three aspects of the Bill which are of primary relevance to Aurizon Network, and our response to each is summarised as follows
 - (a) Removal of references to the pricing principles from several sections of the Act (**Pricing Principles Amendment**). Aurizon Network has concerns in relation to this aspect of the Bill.
 - (b) The alignment of the access criteria in the QCA Act to the proposed changes to the declaration criteria within the national access regime and the principles in clause 6 of the COAG Competition Principles Agreement (**Access Criteria Amendment**). Aurizon Network has no specific comments in relation to this aspect of the Bill.
 - (c) A requirement that the QCA publish intended remedial actions if it misses its current statutory deadlines for decisions (**QCA Timelines Amendment**). Aurizon Network supports these amendments.
- 3 Our detailed comments are set out below. We would welcome the opportunity to meet with you to discuss any aspect, once you have reviewed our submission.

Pricing Principles Amendment

Executive summary

- 4 The proposed amendments to remove references to the pricing principles from various provisions of the QCA Act have significant unintended economic impacts.
- 5 While the changes are said to address potential uncertainty by removing references to the pricing principles from the QCA Act, the proposed changes are in fact likely to have the opposite effect as without them, potential regulatory outcomes are less clear.
- 6 In this regard it is relevant that a detailed review of the history of the introduction of the pricing principles reveals that they were in fact intended to provide greater certainty and consistency in regulatory decision-making.
- 7 In respect of the Queensland access regime, the Explanatory Notes for the introduction of the pricing principles into the QCA Act (including the provisions earmarked for amendment) expressly state that Parliament intended the pricing principles to provide “**overriding guidance**” to the QCA in its decision making.
- 8 De-emphasising the pricing principles:
 - (a) is likely to have a negative effect on investment in critical Queensland infrastructure because investors cannot have any certainty that they will recover at least their efficient costs and a return to cover regulatory and commercial risks, as currently contemplated by the pricing principle in section 168A(a) of the QCA Act; and
 - (b) is inconsistent with the objects of Part 5 of the QCA Act which include the promotion of “economically efficient investment in significant infrastructure... with the effect of promoting effective competition in upstream and downstream markets”.

- 9 For all the reasons outlined above, Aurizon Network submits that the case for the proposed amendments is not made out and that as the proposed amendments have potentially material significant and likely unintended consequences, they should not be made.
- 10 If despite this submission the Bill is to be recommended for enactment, Aurizon Network requests that the Economic and Governance Committee consider proceeding with the proposed changes subject to an important qualification

Aurizon Network asks that the Explanatory Notes accompanying the proposed amendments expressly include confirmation that, the pricing principles in section 168A of the QCA Act are to continue to provide overriding guidance to the QCA, with departures from those principles to be limited to those exceptional cases where there is demonstrated, genuine economic justification and a lack of prejudice to the objects of Part 5 of the QCA Act.; and

The pricing principles

- 11 The pricing principles relate to the price for access to a service and are principles that the QCA must have regard to when considering an application to approve an access undertaking – section 138(2)(g).
- 12 There are four pricing principles listed in section 168A of the QCA Act. The first of those is that the price for access should:
- “generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved” – section 168A(a).*
- 13 The pricing principles, and in particular, the principle in section 168A(a), are consistent with and underpin the object of Part 5 of the QCA Act (access to services). The object of Part 5 is found in section 69E and reads:
- “The object of this part 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.”*
- 14 The pricing principles are also referenced in sections 100(4), 138A(2), and 168C(3) of the QCA Act. Each of those sections places a limit on the extent to which an access undertaking or the terms of access can discriminate as between access seekers and as between access holders (as applicable). In each case the constraint imposed by the QCA Act is to ensure that any such discrimination does not offend the pricing principles.
- 15 The effect of those provisions, particularly sections 138A(2) and 168C(3), is to ensure and support the application of the pricing principles which are themselves consistent with one of the objects of Part 5 of the QCA Act namely, to promote effective competition in upstream and downstream markets.
- 16 The Bill proposes to remove the protection and priority given to the pricing principles from each of sections 100(4), 138A(2) and 168C(3).

Stated rationale and objective of the proposed changes

- 17 The Consultation Paper published in relation to the Bill does not offer a detailed rationale for the proposed changes beyond the following:

“The Consultation Draft removes these references to the pricing principles from sections 100(4), 138A(2) and 168C(3) of the QCA Act to avoid any potential uncertainty these references may cause as to how the pricing principles are to be taken into account by the QCA when making an access determination or deciding whether to approve a draft access undertaking”.

- 18 The Consultation Paper does not elaborate on the “*potential uncertainty*” that the Bill is intended to cure by removal of the relevant references to the pricing principles.
- 19 The Consultation Paper does reveal the objective of the proposed changes. That objective is apparently to make clear that the QCA does not need to be assured that each of the pricing principles is satisfied and that the QCA is free to determine the weight to be given to the pricing principles in the exercise of its decision-making functions.¹
- 20 Based on the rationale and objectives in the Consultation Paper, the QCA would be free to make a decision which could, for example, force an access provider like Aurizon Network or Queensland Rail to provide access to a declared service at less than its efficient costs – i.e. potentially at a loss.
- 21 Aurizon Network submits that such an outcome is inconsistent with the objects of Part 5 of the QCA Act and not one that should be given life without carefully considered justification.

Implications for future investment decisions

- 22 Access providers such as Aurizon Network will only make significant investment decisions to build, operate and maintain major infrastructure assets if there is a sufficient degree of certainty over the revenue those assets will generate.
- 23 One of the key pricing principles found in section 168A(a) of the QCA Act dictates that the price for access “*should generate expected revenue that is at least enough to meet the efficient costs of the providing access to the service, and include a return on investment commensurate with the regulatory and commercial risks involved*”.
- 24 The purpose and effect of section 168A(a) is to effectively create a floor price for the granting of access; a floor to cover efficient costs and the specified return on investment.
- 25 However, based on the Consultation Paper, the proposed amendments are designed to ensure that the QCA is free to make decisions that do not necessarily satisfy each of the pricing principles. With the amendments proposed in the Bill the QCA would be free to not apply the pricing principle in section 168A(a), or to effectively trade it off against other matters to which the QCA must also have regard.
- 26 That necessarily means that if the amendments are enacted Aurizon Network and other access providers cannot be sure that they will receive at least their efficient costs and the return specified in section 168A.
- 27 The lack of that certainty over returns has the real potential to significantly adversely affect the willingness of investors to undertake investments in future enhancements and expansions to the infrastructure used to provide the declared service. That is because the protection of shareholder interests and associated investment decision criteria, will always be likely to require some certainty that a material investment will recoup costs and an appropriate return, even where the services using the asset base are regulated.

¹ See last two sentences of Section 2.3 of the Consultation Paper.

- 28 The very significant impacts that the proposed changes are likely to have on investment decisions does not appear to have been fully taken into account in the proposals for amendment and is a matter that Aurizon Network submits is of such fundamental importance that it militates against the making of the proposed amendments.

Original purpose for the introduction of the pricing principles

- 29 As stated above, the Consultation Paper issued by Treasury and relevant to the Bill states that the removal of the references to the pricing principles from the relevant sections is needed to remove “*potential uncertainty*”.
- 30 The Consultation Paper fails to fully articulate how the existence of the current references to the pricing principles create uncertainty. Aurizon Network submits that the references to the pricing principles in the relevant provisions of the QCA Act do the exact opposite – they create certainty because access providers, access seekers and access holders all know that whatever else the QCA may decide, the price for access principle and the other pricing principles must always be preserved.
- 31 Aurizon Network has undertaken a detailed analysis of the various reports, reviews and Explanatory Notes justifying and explaining the introduction of the pricing principles into the national and Queensland access regimes.
- 32 We can confirm in the interests of brevity that the review consistently and unequivocally reveals that the pricing principles were introduced to provide:
- (a) greater certainty to market participants;
 - (b) greater consistency in regulatory decisions; and
 - (c) consistency with, and support for, the object of encouraging efficient investment in infrastructure used to provide declared services.
- 33 **Importantly**, in the case of Queensland, the decision to introduce pricing principles was explicitly intended to provide “*overriding guidance*”. The Explanatory Notes to the *Queensland Competition Authority Amendment Act 2008* by which the current objects clause and pricing principles were introduced to the QCA Act relevantly state:
- “The inclusion of an objects clause and uniform pricing principles will provide overriding guidance for the Authority and Ministers in making regulatory decisions under the access regime in the Act.***
- The same clause and principles will be applied to all jurisdictions’ access regimes which will promote national consistency in regulatory practice, contribute to consistent and transparent regulatory outcomes and increase certainty for investors, access providers and access seekers which will benefit infrastructure investment.”***² (Emphasis added.)
- 34 The Consultation Paper does not explain why the “overriding guidance” considered appropriate by the Parliament when the objects clause and the pricing principles were introduced to the QCA Act is no longer considered necessary and indeed, considered a hindrance to certainty.

² At page 4.

- 35 Against this background, any decision to de-emphasise the pricing principles needs to be carefully considered and fully justified. In Aurizon Network's view these standards are not met in relation to the Bill.

Conclusion on Pricing Principles Amendment

- 36 In light of all of the above, Aurizon Network submits that it is not appropriate for the State to enact the proposed amendments to remove the references to the pricing principles as proposed.
- 37 However, if despite the matters raised in this submission the Committee decides to recommend the proposed amendments in the Bill for enactment, Aurizon Network requests that Committee do so having regard to the matters in paragraph 10 in the Executive Summary of this section of its submission.

Access Criteria Amendment

- 38 Aurizon Network understands that the purpose of the amendments is to bring the access criteria in the QCA Act into line with changes proposed to clause 6 of the COAG Competition Principles Agreement (**CPA**) relating to declaration criteria (**Proposed COAG Declaration Criteria Amendments**) and also to proposed changes to those criteria within the national access regime contained in Part IIIA of the Competition and Consumer Act 2010 (Cth) (**CCA**) (**Proposed CCA Declaration Criteria Amendments**).
- 39 In principle, Aurizon Network has no objection to an alignment of the access criteria to the Proposed COAG and CCA Declaration Criteria Amendments, given the extensive consultation which has already occurred at a national level in respect of these provisions.

QCA Timelines Amendment

- 40 Aurizon Network supports these amendments, as they drive additional regulatory accountability, while still permitting sufficient timeframe flexibility to enable the QCA to:
- (a) conduct the detailed inquiries necessary to support well-reasoned, evidence-based regulatory decisions, and
 - (b) ensure all parties are accorded a fair hearing.

Conclusion

Aurion Network would welcome the opportunity to respond to any questions the Committee may have in relation to the matters addressed in this submission.