

Regulatory Environment

We seek to play an active role in encouraging infrastructure investment and efficient use of Australia's supply chains.

WHY IS REGULATION IMPORTANT TO AURIZON?

All of our revenue and many of our costs are directly or indirectly impacted by regulation in Australia, from economic to environmental and safety regulation. Last year we explained the major aspects of economic regulation and the expected release of the updated Access Undertaking (UT4) that determines our regulated returns for the Central Queensland Coal Network (CQCN).

In April 2016 the Queensland Competition Authority (QCA) released its Final Decision. Aurizon Network has communicated it will move forward with this decision in light of the current economic climate and in order to provide certainty for the industry and stakeholders. Notwithstanding this acceptance, Aurizon will actively seek to ensure future processes are undertaken in accordance with the original intent of the QCA Act. Aurizon believes this would result in more commercial and economic outcomes for the industry and the State. A summary of the key UT4 outcomes over the period (FY2014 - FY2017) is provided below:

- Maximum Allowable Revenue (MAR) averaging approximately \$1 billion per year.
- QCA forecast volumes averaging approximately 220 million tonnes (mt) per year.
- Weighted Average Cost of Capital (WACC) of 7.17% generating an average return on capital of approximately \$383 million per year based on forecast Regulated Asset Base (RAB) valuation.
- Revenue deferral for Wiggins Island Rail Project (WIRP) volumes not expected to rail during the period.

Since UT4, a number of customer consultations and briefings were held on UT5 (which is intended to cover the period FY2018 to FY2021). It is currently anticipated to be in place during 2017.

UT5 is expected to provide Aurizon below rail network infrastructure (Network) with an appropriate model that has the foresight to consider future risks and opportunities including:

- expected continuation of record system volumes
- continuation of sustainable maintenance and capex regimes to ensure safety compliance and improve system efficiency
- a WACC outcome that supports ongoing investment.

We believe the process of UT5 presents Aurizon with a clear opportunity to demonstrate our strength in engagement with a broad spectrum of external stakeholders. These include:

- customers requiring fair and efficient pricing
- operators who desire access to a safe and reliable rail network
- regulators supporting a transparent and timely process to determine an appropriate return reflecting costs and risks
- local and state Governments who support on-going investment and growth.

WHY IS REGULATION IMPORTANT TO AUSTRALIA?

The regulation of the rail sector and trade underpins Australia's economic competitiveness and ability to compete globally, so it is critical that regulation supports efficiency, competition and access to export markets. As Australia has geographically dispersed population centres, and is the leading exporter globally in the two largest seaborne dry bulk markets (iron ore and coal), the cost of transport and elimination of any barriers to trade are critical to Australia's competitiveness.

For the rail sector, regulation is important where it is prohibitive to duplicate rail infrastructure and there are few alternatives. Rail is also different to other types of regulated infrastructure, for example telecommunications, as operating rail services requires the direct use of the infrastructure.

When regulation is well designed and appropriately applied it can deliver optimal supply chains for users and incentives for investment to improve supply chain capacity. Where rail competes with road, regulation is also important in achieving a balance between economic, environmental and social impacts and to enable the necessary scale to reduce transport costs. >>

"Quite simply, the future of Australia's economic prosperity — and local jobs — is highly dependent on strong ongoing trading relationships."

Lance Hockridge
ChAFTA forum September 2015.

SUPPLY CHAIN INTEGRATION

While Australia's bulk supply chains are among the world's best, this advantage is subject to international competition. At a global level, most bulk rail operations are vertically integrated, which means that above and below rail work together under common ownership or control to consider joint impacts on the total cost of rail services to end customers. In Australia, it's more typical for the operation of multi-user rail infrastructure to be separated between network providers

and rail operators. Based on experience in the CQCN, Aurizon believes common operation of both above rail and below rail, with appropriate targeted regulation, can provide benefits to users.

Another key aspect of supply chain integration is coordinating transportation (track access and rolling stock availability) with port capacity to help meet demand with optimised throughput. To enable this coordination, Aurizon Network participates in supply chain groups including the Capricornia Coal Chain

Steering Committee and Abbott Point User Group, contributing its expertise to improve supply chain performance. Aurizon believes that clear communication around scheduling and planning is imperative to optimise supply chain outcomes for all users.

Since FY2012, Aurizon's productivity gains and active support of supply chain integration has contributed to a 36% increase in coal volumes and a reduction in below rail rates in real terms.

ENABLING MODE SHIFT

Mode shift (from road to rail) is needed to cope with the growth in the national land freight task as the volume of freight is expected to grow by 80% between 2010 and 2030¹⁶.

By contrast, rail is unable to effectively compete on equal terms with road freight due to separate and inconsistent systems of regulation and disparity between road pricing and rail access charges. Rail access charges are determined on a transparent and cost-reflective basis. By contrast, the current road freight pricing regime for heavy vehicles does not provide a clear and direct relationship with the costs of allowing heavy vehicles access to major road freight routes.

To ensure sustainable transport of freight within Australia, efforts should be made to limit the associated impacts on the environment and society. Rail freight has significant potential to reduce carbon emissions, avoid higher accident costs and limit the extent of congestion in urban centres. To do this, urgent reform is also needed to help rail achieve the scale to effectively compete with road.

Aurizon strongly supports the decision of the Council of Australian Governments (COAG) to transition to independent price regulation of heavy vehicle charges by 2017-18. We are working co-operatively with Federal and State Governments, as well as key industry associations such as the Australian Logistics Council,

to develop a consistent set of economic principles to be applied to road freight charging and investment reform. The transition to competitive neutrality between road and rail is important for promoting effective competition, as well as improving productivity and innovation, and maximising consumer benefits.

In addition, Aurizon has also taken its own proactive steps to enable mode shift and the alleviation of congestion in metropolitan Sydney. In August, we ran our first port shuttle from Port Botany to our intermodal terminal at Enfield. We plan to continue to grow this rail sector for our customers, as well as for the community of Sydney.

REDUCING BARRIERS TO TRADE

The movement of goods, services and capital has been essential for the development of Asian economies and Australian export industries. Aurizon is heavily influenced by international trade with over 90% of our transport volumes destined for export. As such, any changes to the rules and terms of trading can have a profound effect on living standards of Asian economies and Aurizon's operations.

In a period where some countries are beginning to reassess their trading relationships, Australia should be seen as a champion for the continuation of trade liberalisation. Free trade agreements (FTAs) such as those recently ratified with Japan, South Korea, the United States and China are key to providing a more competitive platform for Australian exports, better access to lower cost inputs for business and choice for consumers. Similarly, foreign direct investment has been a critical factor in expanding the productive capacity of Australian agricultural, mining and processing industries with heavy financial involvement of end customers.

The ratification and implementation of the [China-Australia Free Trade Agreement \(ChAFTA\)](#) in December 2015 was a significant achievement for advocates of free trade and facilitated the following reduction in coal import tariffs:

- Metallurgical coal: 3% tariff eliminated on 20 December 2015.
- Thermal coal: 6% tariff to be eliminated on 1 January 2017.

Agreements such as this accentuate the benefits of pursuing trade openness for Australia, and demonstrate the benefits yet to be gained through similar FTAs under negotiation with India and Indonesia.

MANAGING ENVIRONMENT, HEALTH AND SAFETY REGULATION

Regulation is often the means by which governments consider societal expectations and industry's social license to operate. Aurizon is committed to working with governments to reduce environmental, health and safety risks to our communities, particularly coal dust, air quality, noise and level crossing incidents. The Environmental Management and Community Engagement chapters of this Report set out a number of relevant examples.

Aurizon believes that voluntary industry codes may be an appropriate first step, but recognises that in some cases regulatory action may be adopted where it is demonstrably required. While it can be an effective safety net, it should not unintentionally constrain activities or impose unnecessary costs. Regulatory decisions should be fully informed by the ability to incentivise the desired outcomes based on:

- evidence-based decision making
- being proportionate to the demonstrated risks
- delivering cost-effective outcomes for the impacted industries and the overall community.

These principles are consistent with the 2007 Council of Australian Governments (COAG) agreement on Best Practice Regulation.

Finally, when regulation is applied it must ensure national consistency of systems, standards and processes or 'harmonisation' to reduce the regulatory burden where appropriate. While progress is being made, Aurizon still encounters what it views as unnecessary regulatory differences across, and within, state boundaries in Australia that continue to create inefficiencies for the rail industry nationally.

¹⁶ Freightline 1 – Australian freight transport overview, BITRE 2014.