

asciano

Submission to the Queensland Competition Authority
Draft Decision on the Maximum Allowable Revenue
Component of the Aurizon Network Draft Access
Undertaking



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1. Introduction

Asciano welcomes the opportunity to make this submission to the Queensland Competition Authority (QCA) on the QCA's Draft Decision on the Maximum Allowable Revenue (MAR) component of the Aurizon Network 2014 Draft Access Undertaking (2014 DAU).

Asciano understands that a further QCA Draft Decision on the price and policy component of the Aurizon Network 2014 Draft Access Undertaking will be released in December 2014. Asciano expects to make a substantial submission to this further QCA Draft Decision.

Asciano has previously had concerns with the separation of these draft decisions; however Asciano welcomes the QCA position that there will be a single Final Decision on all elements of the 2014 DAU. Asciano believes that the 2014 DAU is a single proposal where the elements of the proposal are interrelated such that final decisions on these elements should not be made in isolation. Rather, a single decision has to be made by the QCA which takes into account the whole of the 2014 DAU proposal.

As the QCA is aware Asciano has previously made numerous submissions on the 2014 DAU, notably submissions in October 2013 and October 2014. Asciano is seeking that these previous submissions continue to be taken into account by the QCA in the current regulatory process if they are relevant to the issue under consideration.

Asciano, via its Pacific National subsidiary, is an access holder and above rail operator on the Aurizon Network. While Asciano is an access holder it does not ultimately pay for rail access on the Aurizon Network as the network access charges are passed through to the end users for payment. However, in its capacity as an above rail haulage operator Asciano will be particularly impacted by the MAR Draft Decision and Final Decision in a number of ways, including:

- MAR allowances and assumptions relating to operating costs and maintenance costs directly impact on both current and future Asciano above rail operations on the Aurizon Network;
- MAR assumptions and forecasts relating to volumes will act as an input to both Asciano decisions and external decisions which impact on current and future Asciano above rail operations on the Aurizon Network;
- MAR allowances and assumptions relating to capital expenditure impact on future Asciano above rail operations on the Aurizon Network;
- MAR allowances and assumptions relating to asset valuation, depreciation and rate of return will act as an input to external decisions which impact on current and future Asciano above rail operations on the Aurizon Network; and
- The MAR in its totality impacts on the longer term viability of the central Queensland coal supply chain, which has a direct impact on future Asciano operations on the Aurizon Network.

Given the impact that the MAR Draft and Final Decisions have on Asciano's operations, Asciano is concerned that regulatory decisions on the MAR components are the best regulatory decisions that can be made.

This submission is a public document.

2. Asciano Comment on the QCA's Draft Decision on the MAR Component of the Aurizon Network 2014 DAU

Asciano strongly supports the QCA's Draft Decision on the MAR Component of the Aurizon Network 2014 DAU.

Asciano believes that in the absence of compelling new information being provided by respondents to this regulatory process, then the recommendations contained in the QCA's Draft Decision on the MAR Component of the Aurizon Network 2014 DAU should be reflected in the QCA's Final Decision on the Aurizon Network 2014 DAU.

MAR

Asciano supports the MAR proposed by the QCA in the Draft Decision and believes that it meets the requirements of the Queensland Competition Authority Act 1997 (QCA Act) and in particular the requirements of sections 69E and 168A of the Act that the MAR cover efficient costs of providing the access service.

The objective of Part 5¹ of the QCA Act as set out in section 69E 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.

The economically efficient operation of, use of and investment in infrastructure such as the Aurizon Network rail network requires that capital costs be efficient and operating and maintenance costs be efficient, thus Aurizon Network should only be allowed to recover its efficient costs.

Similarly section 168A of the Act provides that revenue from the access service should cover the efficient costs (including capital costs) of providing such access.

Volume Forecasts

Asciano's previous responses on Aurizon Network volume forecasting sought to:

- limit Aurizon Network's discretion in relation to volume forecasting;
- increase the transparency of Aurizon Network's volume forecasting; and
- involve supply chain stakeholders such as mines, above rail operators and ports in the volume forecasting process.

Asciano is concerned that Aurizon Network has a degree of discretion in determining forecasts and this discretion may be used to favour Aurizon Network's interests in matters such as access tariff determination and take or pay triggers.

¹ Part 5 of the QCA Act relates to access to services. The Aurizon Network DAU has been submitted under Part 5 of the QCA Act.

Asciano notes that the QCA has engaged a consultant (Energy Economics) to assess Aurizon Network's volume forecast, and while Asciano has no comment on the accuracy of the consultant's forecast, Asciano believes that independent forecasts or independent scrutiny of Aurizon Network's forecasts will reduce concerns that Aurizon Network forecasts are determined to favour Aurizon Network's interests.

The Draft Decision proposes to use Energy Economics volume forecasts for 2014-15 to 2016-17. Given that the Final Decision is due in May 2015² Asciano believes that the Energy Economics volume forecast for 2014-15 should be adjusted for actual 2014-15 monthly figures for the first six to nine months of 2014-15 (depending on the availability of volume data).

Operating Costs

As required by the QCA Act, Aurizon Network should only be allowed to recover its efficient operating costs.

In considering operating costs the Draft Decision has allowed operating costs of \$760.8 million over four years, which is \$139.1 million less than Aurizon Network sought in its revised DAU costing of December 2013.

Asciano supports these lower operating costs and, in particular supports the \$84.8 million reduction in corporate overheads. As outlined in Asciano's October 2013 submission to this regulatory process, Aurizon Network's proposed increase in corporate costs allocated to the rail network had several impacts on competition and efficiency, namely:

- it shifted access tariffs further away from being cost reflective efficient tariffs; and
- it provided a cost advantage to Aurizon Network's related above rail operator as they would no longer have to carry a reasonable allocation of corporate costs, thus providing them with a competitive advantage compared with other above rail providers.

Given the second point above Asciano believes that the QCA needs to establish systems to allow ongoing scrutiny of Aurizon and Aurizon Network cost allocations in order to ensure users of the Aurizon Network are not subsidising broader Aurizon activities in either above rail activities or interstate activities.

Overall Asciano believes that the lower operating costs allowed under the Draft Decision are more reflective of an efficient below rail operator than the costs submitted by Aurizon Network in its DAU.

Maintenance Costs

As required by the QCA Act, Aurizon Network should only be allowed to recover its efficient maintenance costs.

In considering maintenance costs the Draft Decision has allowed maintenance costs of \$737.7 million over four years, which is \$328.4 million less than the costs submitted by Aurizon Network in its DAU. The major components of this reduction include:

² As per table 5 on page xvi of the QCA Draft Decision

- a \$116.8 million reduction in ballast undercutting costs; and
- a \$55.46 million reduction in corporate overheads.

In relation to these cost reductions, Asciano strongly supports the reduction in corporate overheads for the reasons outlined in the section above.

The main driver of the reduction in the maintenance costs is the Draft Decision's treatment of ballast undercutting costs. In the 2010 Access Undertaking Final Decision, the QCA effectively imposed a ballast maintenance impairment charge on Aurizon Network. The Aurizon Network 2014 DAU sought to reverse this impairment charge and allow for the ballast maintenance costs to be increased. The current Draft Decision has rejected this Aurizon Network position. Asciano supports the Draft Decision position on ballast maintenance costs. Asciano has concerns that re-opening an assessment of costs incurred prior to 2010 may be problematic due to industry and Aurizon changes since that time and may set a precedent for historic costs and practices and costs determined in previous undertakings to be regularly re-assessed in future undertakings. Asciano's view is that access undertaking revenues and prices should be based on forward looking cost estimates and once determined, access undertakings should not be re-opened to adjust for cost information. Such an approach gives the access provider an incentive to reduce its actual costs below the forecast costs. Re-opening historic access undertakings to adjust for costs (either up or down) removes this incentive.

Further to this issue the parties which benefit or are penalized by such an adjustment are not the same parties. For example the owners of Aurizon Network in 2015 which would benefit from the removal of the impairment charge are not the same owners of Aurizon Network in 2010.

As a train operator on the Aurizon Network, Asciano strongly supports an efficient and effective Aurizon Network infrastructure maintenance program. Asciano supports the Draft Decision position on maintenance costs but Asciano does not believe that maintenance costs should be substantially reduced further, as any further substantial reductions in maintenance costs have the potential to impact on track quality and hence train operation and coal supply chain efficiency.

Overall Asciano believes that the lower maintenance costs allowed under the Draft Decision are more reflective of an efficient below rail operator than the costs submitted by Aurizon Network in its DAU and these costs should be maintained in the Final Decision.

Asset Value and Capital Expenditure

The Draft Decision has accepted the inclusion of Wiggins Island Rail Project (WIRP) capital costs from 2015-16.

Asciano has raised various issues in relation to WIRP in its October 2014 submission to the QCA. Asciano believes that:

- only users which benefit from the WIRP infrastructure should pay the capital costs related to this infrastructure;
- forecasts of WIRP volumes should be realistic. WIRP forecast volumes are currently set at 90% of contracted volumes. Asciano queries if these forecasts are realistic; and

- the allocations of WIRP assets between users and between systems (Blackwater and Moura) need to be scrutinised to ensure there is no cross subsidisation between users or systems.

While Asciano believes that inclusion of WIRP assets is appropriate at this time Asciano believes that, depending on the actual volumes using WIRP, the allowance for the WIRP capital costs should be reviewed at the next undertaking in order to ensure that the capital costs included are optimised.

Return of Capital

Asciano supports the Draft Decision's position to not change depreciation arrangements to reflect Aurizon Network's assessment of weighted average mine lives.

Aurizon Network has argued that this is necessary to reduce its risk. However, Aurizon Network is already largely protected from risk by the regulatory framework (for example Aurizon Network are protected via the revenue cap mechanism and via take or pay contracts, both of which effectively underwrite revenue regardless of volume). Asciano believes that a change in depreciation arrangements would provide Aurizon Network with even more risk protection, which is not needed.

To ensure greater pricing certainty for users, any proposal to change depreciation arrangements should not be allowed.

Return on Investment

Asciano has no detailed comment on the Draft Decision's recommendations relating to the return on investments (i.e. the weighted average cost of capital).

As noted in the section above, Aurizon Network is already largely protected from risk by the regulatory and commercial frameworks in place. Asciano believes that any regulatory assessment of the risk – return tradeoff and the Aurizon Network return on investment should take these factors into account.

3. Conclusion

Asciano strongly supports the QCA's Draft Decision on the MAR Component of the Aurizon Network 2014 DAU. In particular Asciano supports the Draft Decision's treatment of corporate overheads in both the operating costs component and the maintenance cost component.

Asciano believes that in the absence of any compelling new information being provided in this regulatory process, the recommendations contained in the QCA's Draft Decision on the MAR Component of the Aurizon Network 2014 DAU should be reflected in the QCA's Final Decision on the Aurizon Network 2014 DAU.



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