



Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4000

6 February 2015

By email: Aurizon@qca.org.au

Dear Malcolm,

RE: Wiggins Island Rail Project (WIRP) Proposed Pricing Treatment

Wiggins Island Rail Project (“WIRP”) users collectively Washpool Coal Pty Ltd, Caledon Coal Pty Ltd, Wesfarmers Curragh Pty Ltd, Colton Coal Pty Ltd, Cockatoo Coal Pty Ltd, Yarrabee Coal Company Pty Ltd, and Glencore Coal Assets Pty Ltd (“WIRP Users”), welcome the opportunity to provide this submission to the Queensland Competition Authority (“QCA”) regarding Aurizon Network’s (“AN”) WIRP tariff proposal (“Proposal”).

The WIRP Users support AN requesting a new reference tariff for WIRP train services, in accordance with the 2010 Access Undertaking (“UT3”).

This submission sets out the WIRP Users’ views on the Proposal, as well as other submissions made to the QCA by other stakeholders on related matters, and seek QCA’s consideration of the following key areas:

- Volume forecasts;
- Application of UT3;
- Capital and Operating Costs; and
- Pricing.

In summary, the WIRP expansion:

- should be judged using the John T. Boyd medium tonnage volume forecast for the purposes of establishing take or pay triggers;
- should be priced using the investment structure that was in place at the time of investment – UT3;
- provides improved reliability (and, therefore, robustness) to the relevant coal systems;
- provides greater flexibility for the management and maintenance of the relevant coal systems;
- benefits non-WIRP users operationally (which is borne out by the actions of some non WIRP Users in supporting the construction to be accelerated);
- has been scrutinised by the WIRP Users for prudence and efficiency, from both a WIRP and non-WIRP perspective; and
- benefits non-WIRP users in both the Blackwater system and Moura system by reducing their access charges.

1. Volume forecasts

As set out in our recent submission on the QCA's draft decision regarding AN's 'Maximum Allowable Revenue', the WIRP Users firmly believe the John T. Boyd Company medium case scenario (set out in its independent analysis of WIRP tonnage forecasts) represents a reasonable volume forecast for the purposes of estimating throughput at Wiggins Island Coal Export Terminal ("**WICET**") and on the rail network to WICET.

Further, the WIRP Users remain of the view that even the medium case scenario is a conservative forecast for the following reasons:

- individual volumes forecast by some WIRP Users exceed those set out in the John T. Boyd report; and
- it is highly likely that there will be demand for consuming additional 'ad-hoc' port capacity at WICET by non-WIRP tonnages. The expectation of consuming such 'ad-hoc' capacity is further evidenced by the current, and forecast, strong demand for export capacity through AN's network.

As such, the WIRP Users strongly believe an inherent level of confidence can be placed in the Boyd medium case scenario as the WIRP Users believe it reflects a minimum in terms of WIRP volumes over the UT4 period, and beyond.

WIRP Users acknowledge that some other stakeholders have expressed concerns regarding Take-Or-Pay ("**ToP**") risks associated with AN's previously proposed forecast of 90% of WIRP contracted tonnage being delivered, particularly in relation to the premature triggering of incumbent liabilities resulting from such an aggressive WIRP forecast. However, in light of the more reasonable and balanced view of expected WIRP railings now being proposed, it is understood that any perceived ToP risks associated with non-WIRP volumes are mitigated, if not slightly improved.

2. Application of UT3

The WIRP Users agree with AN's assessment that the pricing principles set out in Part 6 and Schedule F of UT3 should be used as the basis for pricing WIRP Train Services and the pricing principles set out in UT4 should not apply for the following reasons:

- the WIRP infrastructure was committed to during UT3, some nineteen months ahead of Aurizon Network's UT4 DAU; and
- the WIRP Users, along with AN, relied on the pricing principles applicable under UT3 (absent any alternative pricing model being available for them to consider) for their initial investment decisions and all related and consequential investment decisions.

In particular, the WIRP Users are of the opinion that:

2.1 Expansion Pricing within an Individual Coal System

There is no test required under UT3 to determine whether inclusion of Capital Expenditure for expansion infrastructure within the Regulatory Asset Base adversely affects the prices paid for Access Rights by existing Access Holders in relation to existing hauls which are within an Individual Coal System. The test that is applied to Capital Expenditure relates only to the Prudence of the Capital Expenditure. This test does not take account of whether or not the inclusion of the Capital Expenditure in the Regulated Asset Base would raise or lower the prices paid by existing Access Holders within the Individual Coal System. Notwithstanding the fact that there is no threshold test for including Capital Expenditure for expansions in the Regulated Asset Base, modelling indicates existing Access Holders would be better off in any case.

The proposed process which applies to expansion pricing under UT4 is not part of the UT3 process. Under the UT4 process put forward by AN, a socialisation test is applied to determine whether the inclusion of the expansion capital expenditure within the coal system would raise prices for existing users. If tariffs for existing users would rise, then the expansion access rights will be subject to an expansion tariff. Most notably, the relevant access seekers are informed of this likelihood prior to contracting for any access rights. If the access seekers decide to proceed with contracting for the access rights, it is with the understanding that an expansion tariff may apply.

At no time was this process discussed, adopted, nor even conceived of, during the WIRP negotiations.

2.2 WIRP Reference Tariff

WIRP represents the incremental capacity expansion of two existing Individual Coal Systems, namely Blackwater and Moura.

It is therefore in a different category from, for example, the GAPE project, which involved the construction of a new section of rail network which did not fall within any existing Individual Coal System.

The WICET unloading facility fits within the definition of both the Blackwater and Moura Systems. The WIRP Users understand that the only reason that WIRP is not dealt with in accordance with the process for including Capital Expenditure in the Regulated Asset Base in Schedule A of UT3 is that the Train Service Entitlements relating to WIRP go to a different Nominated Unloading Facility where there is no existing Reference Tariff.

2.3 Process for setting Reference Tariffs

Under UT3, the process for setting a Reference Tariff for a new coal carrying Train Service is dealt with under clause 4 of Schedule F, Part B. Under clause 4.1.2 a test is applied under which the Reference Tariff to be applied is determined as the higher of the \$/ntk basis of the Reference Tariff for the Individual Coal System (clause 4.1.2(a)) or an alternative tariff calculated on the basis set out in clause 4.1.2(b). The alternative tariff is the sum of:

1. the new coal carrying Train Service's Private Incremental Costs (if any);
2. the Incremental Costs of using any Rail Infrastructure specifically related to the new coal carrying Train Service; and
3. the required minimum Common Cost contribution determined in accordance with clause 4.1.1 of Schedule F Part B.

The WIRP Users contend that AN has not given full effect to the terms of clause 4.1.2(b) for the following reasons:

- the clause requires that Incremental Costs included in the assessment of the alternative tariffs are only those for "Rail Infrastructure specifically related to the new coal carrying Train Service";
- the majority of the Rail Infrastructure relating to the WIRP Train Services is Rail Infrastructure which is not specific to WIRP volumes, i.e. the majority of the Rail Infrastructure delivered as part of the WIRP expansion is fully integrated in to the existing rail network/s
- the majority of the WIRP expansion will provide significant operational benefit to all producers, WIRP and non-WIRP alike, by improving the robustness and reliability of the coal systems;

- parts of the WIRP expansion were solely for the benefit of existing users, for example including the electrification of all new Blackwater assets even though none of the WIRP Users intended to adopt electric traction; and
- the majority of the WIRP expansion will enable more flexibility for AN's maintenance program and, as a result, benefits non-WIRP and WIRP producers alike.

Given the UT3 position in relation to the inclusion of Capital Expenditure within the Regulatory Asset Base (i.e. that no test is applied in relation to the effect of its inclusion on the tariffs paid by existing Access Holders), it is not surprising that no socialisation test is applied under UT3 in determining a new Reference Tariff for Rail Infrastructure which is not specific to that Train Service.

Conversely, it would be surprising if a socialisation test was applied as that would mean that decisions regarding the inclusion of Capital Expenditure could be made in an entirely different manner based only on whether an expansion relates to Train Services within an existing haul or to Train Services which terminate at a slightly different location.

The WIRP Users understand that the purpose of the test set out in Schedule F of UT3 is to ensure that those who do not benefit (in any way) from an infrastructure enhancement do not subsidise, or contribute to, that enhancement. This is obviously not applicable to the WIRP expansion, as **the benefits derived from the enhancements cannot be quarantined to only the WIRP volumes.**

WIRP Users therefore submit that it is incorrect for AN to have proceeded on the basis that an assessment has to be carried out as to how much of the WIRP mainline infrastructure should be considered to benefit non-WIRP volumes based on the utilisation, or the value of the duplications, as set out in section 3.2.3 of the Proposal. Given that the mainline infrastructure is, by definition, not specific to WIRP Train Services then the Incremental Cost of such infrastructure is not relevant for the purposes of the assessment of the appropriate Reference Tariff in accordance with Schedule F Part B clause 4.1.2. As a result, the WIRP Users are of the view that AN's application of these provisions favour non-WIRP volumes.

3. Capital and Operating Costs

3.1 Capital Allocation

The WIRP Users support the methodology adopted by Aurizon to allocate costs among WIRP customers using a proportional share of the Gross Tonne Kilometres (GTK).

As mentioned previously, the WIRP Users consider that it is incorrect that an assessment is even necessary to determine how much of the WIRP mainline infrastructure should be considered to benefit existing non-WIRP users, given the integrated nature of the enhancements.

In any event, it is clear there is a view within the Blackwater system users that the WIRP expansion benefits them, evidenced not only by the pre-existing requests by the non-WIRP users to duplicate the remaining single line sections between Rocklands and Blackwater, but also the non-WIRP users' recent support for accelerating the delivery of the infrastructure enhancements ahead of being required to service the WIRP volumes. The WIRP users did not require acceleration.

For these reasons, the WIRP Users consider the split proposed by AN in the Blackwater system is heavily in favour of the non-WIRP users.

Similarly, with regard to the Moura system, the WIRP Users consider the cost sharing between the WIRP and non-WIRP users should take account of the significant improvement works to the underlying common user track infrastructure within the Moura system (i.e. rectification of long term maintenance intensive sections of track), and the corresponding operational benefits that will be realised as a result.

In addition, further operational benefits are also likely to be achieved from the enhancements on the North Coast Line that will permit improved staging and sequencing of Train Services in to the Gladstone region in general.

3.2 Operating and Maintenance Costs

The WIRP Users agree with the views put forward by AN relating to the WIRP Train Services not contributing to the incremental operating costs of the networks.

As set out in AN's Proposal, "the WIRP programme includes the renewal and replacement of existing assets in the Blackwater and Moura systems. These works are expected to improve the robustness and reliability of infrastructure in the Gladstone area and contribute to reductions in future maintenance costs". Further to this, the WIRP Users are of the view that such benefits extend throughout both systems, as opposed to being limited to just the infrastructure in the Gladstone area.

To this end the WIRP Users believe that AN has understated the operational benefits attributable to the current infrastructure works that will benefit non-WIRP volumes, for instance:

- The Kabra holding roads will assist in managing the misalignment between the 20 minute Blackwater Line headway and the 15 minute North Coast Line headway – improving the robustness and flexibility of the network;
- The Aldoga (and arguably the Kabra) holding road will allow Gladstone area bound trains (i.e. export and domestic) to be held closer to Callemondah yard until congestion within the yard clears without blocking the North Coast Line;
- The design on the WICET balloon loop allows for approximately three loaded trains and one empty train to be held off the network;
- Asset replacements and renewals (i.e. access road upgrades, rail joint replacements, culvert replacements, NCL re-railing, etc.) mitigate critical asset outages and minimising maintenance activities; and
- Improvements to pre-existing level crossings – increase the reliability of the network.

3.3 Efficiency and Prudency

The WIRP Users acknowledge concerns raised by other stakeholders in relation to matters of transparency in determining the efficiency and prudency of the WIRP expansion, on the basis that it is perceived by those stakeholders that they will be asked to pay for such infrastructure enhancements.

WIRP Users are of the view that such concerns are unfounded on the basis that, consistent with AN's Proposal, non-WIRP users will not be exposed to any increase to access charges as a result of the WIRP expansion. Further to this, significant non-WIRP volumes will benefit from reductions to access charges.

The WIRP Users were afforded a reasonable degree of transparency by AN during the development of the WIRP scope of work. The WIRP Users have been diligent in taking advantage of any opportunity to reduce the scope and cost of the expansion but still

maintain the ability to deliver the capacity. This was driven by financial considerations – the WIRP Users are exposed to increased fees under the WIRP Access Conditions.

While all users may not have had the opportunity to review the scope and cost of the expansion, the WIRP users did apply due diligence to the scope to confirm the scope of work was both efficient and prudent. The WIRP Users, through their internal technical experts and specialist advisors, have played an active and integral role in influencing the WIRP programme, and it's ongoing delivery.

It is also key to note that the majority of the WIRP volumes (over 75%) originate from incumbent users, across both the Blackwater and Moura systems. These users also have a significant proportion of non-WIRP volumes. Hence, the WIRP Users have an inherent vested interest in ensuring their own non-WIRP volumes are not adversely impacted as a result of the WIRP expansion.

As a function of this consultative process, and coupled with the fact that the WIRP Users have had to balance their own interests as well, **the WIRP Users are of the strong view that the infrastructure enhancements are appropriate in underpinning the sustainable and robust delivery of the full 108mtpa of supply chain capacity across the combined Blackwater and Moura networks.**

4. Pricing

The WIRP Users acknowledge concerns raised by other stakeholders in relation to the impact of the WIRP expansions on their Train Services. However, it should be noted that the WIRP Access Conditions actually provide an incentive for AN to ensure it delivers the infrastructure that can sustainably deliver the full 108mtpa of contracted capacity into the Gladstone region, being both WIRP and non-WIRP tonnes. This incentive ensures that non-WIRP tonnes receive their full contracted tonnes, but it is underwritten by a top up payment in the WIRP Access Conditions (“**WIRP Fee**”) that is payable by the WIRP Users only.

It was commonly known that AN has taken a commercial position to not invest in network extensions at the standard QCA approved weighted average cost of capital. The WIRP Fee provided the necessary incentive to encourage AN to commit to installing the necessary capacity for both pre-existing requirements and genuine incremental WIRP requirements.

WIRP Users understood from AN that the WIRP extensions would be socialised. This was consistent with WIRP Users accepting AN's desire to electrify all Blackwater duplications and holding roads, and also accepting AN's electrification of the WICET unloading loop, despite WIRP customers planning diesel hauled operations.

Indeed, it could be argued that the WIRP Users are subsidising the works required to deliver the non-WIRP volumes while carrying the risks associated with the inefficiencies of the existing network. The WIRP Users acknowledge it was their decision to provide AN with a higher rate of return on the WIRP infrastructure, but do note that all users (and not just the WIRP Users) in the Blackwater and Moura systems will receive the benefit of the WIRP infrastructure which would not have been built if the WIRP Users had not agreed to pay the WIRP Fee.

The WIRP Users acknowledge and support AN's Proposal in so far as the WIRP revenues generated, and volumes railed, in FY15 will not contribute to System Allowable Revenues (revenue cap) nor the ToP system tests respectively.

4.1 Contributions to Common Costs (“CCC”)

The WIRP Users are of the view that the escalation factor of 5% is aggressive, and overstated.

With regard to the Moura WIRP Train Services, the WIRP Users agree with AN’s analysis and proposed treatment of the WIRP Moura CCC relating to an (initial) otherwise unintended cross-subsidisation of access charges if the strict application of Schedule F, subclause 4.1.2, were to apply. In the absence of departing from such provisions the access charges for non-WIRP tonnages would reduce and the access charges applicable to the WIRP tonnages would be considerably greater – for what is the same train service, and noting that non-WIRP volumes will benefit from the WIRP expansion – distorting competition in the market. As such, the WIRP Users urge the QCA to exercise its discretion in concluding that the Moura WIRP tonnages ought not make a CCC, on the basis that non-WIRP tonnages are no worse off and the WIRP tonnages still pay their way regardless.

With regard to the NCL WIRP Train Services, the WIRP Users agree with AN’s Proposal to determine the CCC in accordance with QCA’s Final Decision (of March 2012) relating to the Train Services from Colton. Further, the WIRP Users seek confirmation that, in line with NCL WIRP Train Services making a CCC to the Moura system, the forecast Colton gtps to be included in the Moura system for the purposes of the ToP trigger.

4.2 Customer Impact

The WIRP Users acknowledge and support AN’s views that:

- **The use of the John T. Boyd medium tonnage volume forecast case for the purposes of establishing ToP triggers will mitigate any perceived increased exposure to ToP by non-WIRP volumes;**
- **Non-WIRP volumes in the Blackwater system will significantly benefit from reductions to access charges as a function of the WIRP; and**
- **Non-WIRP volumes in the Moura system will benefit from reductions to access charges as a function of the WIRP.**

The WIRP Users acknowledge the release of the QCA’s Draft Decision regarding the policy and pricing aspects of UT4, on 30 January 2015, and the exclusion of WIRP costs and volumes. The WIRP Users are fully supportive of the views of the QCA in so far as *“it is in the interests of all CQCN users to have a stable profile of access charges over time to reduce uncertainties consistent with the object of Part 5 of the QCA Act, as it provides an environment that is conducive to mine development in CQCN”*¹, however submit that this principle has to apply to existing and expansion volumes alike. The WIRP Users will respond to matters raised in the Draft Decision in due course.

The WIRP Users consent to this being a public submission.

If you have any questions relating to this submission, please contact our representative Jamie Freeman (jfreeman@balanceadvisory.com).

Yours sincerely

WIRP Users²

¹ QCA Draft Decision : 2014 DAU – Volume III, Pricing & Tariffs, p368.

² Collectively; Washpool Coal Pty Ltd, Caledon Coal Pty Ltd, Wesfarmers Curragh Pty Ltd, Colton Coal Pty Ltd, Cockatoo Coal Pty Ltd, Yarrabee Coal Company Pty Ltd, and Glencore Coal Assets Pty Ltd.