



Submission to the QCA on the Aurizon Network DAAU relating to the Reference Tariff for the GAPE System

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1 INTRODUCTION AND BACKGROUND

Asciano welcomes the opportunity to make a further submission to the Queensland Competition Authority (QCA) in response to the Aurizon Network submission of a Draft Amending Access Undertaking (DAAU) relating to the implementation of reference tariffs for train services operating from the Goonyella system to Abbott Point via the GAPE (Goonyella Abbott Point Expansion).

Asciano has a strong interest in these GAPE reference tariffs via its Pacific National Coal subsidiary. Pacific National Coal has access agreements in place to carry coal via the GAPE and has operated coal trains across the GAPE. Asciano has major concerns with the proposed GAPE reference tariffs and is seeking that these concerns be addressed before the GAPE reference tariffs are approved by the QCA.

In September 2012, Aurizon Network (then QR Network) submitted a DAAU relating to GAPE reference tariffs to the QCA. Asciano made a submission to the QCA on this 2012 DAAU. Aurizon Network then withdrew this 2012 DAAU in April 2013 and submitted an amended DAAU to the QCA. The DAAU is proposing to create a GAPE system which includes both the northern missing link and associated infrastructure enhancements in both the Goonyella and Newlands systems. This GAPE system will have a reference tariff based on incremental cost including the capital cost of the northern missing link, the Goonyella system enhancements, the Newlands system enhancements, incremental maintenance and operating costs associated with the northern missing link and the Goonyella and Newlands system enhancements.

Asciano recognises that the 2013 DAAU submitted by Aurizon Network takes into account some issues raised by stakeholders in their responses to the 2012 DAAU.

Asciano has previously made submissions on the Aurizon Network (then QR Network) 2012 DAAU in November 2012. To the extent that issues raised in this submission have not been addressed in the 2013 DAAU Asciano is seeking that they be considered by the QCA in its 2013 DAAU approval process.

This submission is public.

2 ASCIANO'S GENERAL POSITION ON THE GAPE PRICING ISSUES RAISED IN THE AURIZON NETWORK DAAU

Asciano notes that the GAPE is being defined by Aurizon Network as a new system. Asciano has several broad concerns relating to the proposed GAPE pricing DAAU including:

- Aurizon Network (Supporting Submission page 3, page 11) suggest that in developing the GAPE reference tariff meeting the existing conditions of the Aurizon Network Access Undertaking are not a direct requirement. Aurizon Network state in their supporting submission (page 11):

As Aurizon Network is submitting the GAPE Reference Tariff as a DAAU and not in accordance with the requirements of Clause 6.4.2 it is not an explicit requirement that proposed reference tariff must conform to the relevant provisions of the Aurizon Network Undertaking.

Asciano strongly believes that the principle of this Aurizon Network position should be critically considered by the QCA. Asciano believes that that Aurizon Network must give a strong commitment that the remaining provisions of the Aurizon Network Access Undertaking will be adhered to by Aurizon Network for the regulated component of the proposed GAPE system commercial arrangements.

- Aurizon Network indicates (Supporting Submission page 3) that the GAPE project was underpinned by specific commercial agreements between Aurizon Network and foundation customers, and that costs have been allocated within the GAPE reference tariffs to integrate into those commercial arrangements. Asciano has concerns that such an approach may result in:
 - the GAPE system being priced in a manner that is inconsistent with the current Aurizon Network Access Undertaking; and
 - the GAPE system being priced in a manner which unfairly differentiates foundation customers to non foundation customers (Asciano recognises that some differential treatment is likely to be appropriate).

More generally Asciano has a strong concern that to gain contracted access to firm rail capacity on the GAPE (as opposed to ad hoc paths) an access seeker or user is required to be a signatory to the GAPE Deed. Asciano believes that this requirement acts as a barrier to access and all access seekers should have a right of access.

- Aurizon Network state in their supporting submission (page 11) that:

As coal carrying train services for GAPE customer mines are utilising newly created rail infrastructure not currently included in the CQCR, any costs not already included in existing Reference Tariffs or System Allowable Revenues, including the capital and operating costs associated with the Rail Infrastructure from the GAPE customer mines to Abbot Point, are “incremental” to the GAPE project

This raises concerns regarding Aurizon network's treatment of common costs. If the new rail infrastructure is to be considered a new system then any costs associated with developing that system could be considered "common costs" as defined in the access undertaking (i.e. costs associated with provision of rail infrastructure which are not incremental costs for any particular train service using that rail infrastructure). This raises concerns as to the meaning of "common costs" as used in the Aurizon Network supporting submission to the GAPE, and concerns as to the treatment and inclusion of common costs more generally. Asciano believes that GAPE pricing should be based on a cost allocation approach and common cost approach which is consistent across systems.

- Asciano is concerned that non-GAPE users in the Goonyella system are impacted by the GAPE DAAU. In particular non-GAPE users in the Goonyella system are impacted as GAPE traffic will not make a contribution to the common costs of the Goonyella system and the GAPE has reduced capacity on the Goonyella system (see section 3.2 below).
- Aurizon Network (Supporting Submission page 11) indicates that the GAPE reference tariffs have been developed in accordance with the pricing principles contained in section six of the approved Aurizon Network Access

Undertaking. Asciano believes that the consistency of the GAPE reference tariffs with these principles should be explicitly outlined by Aurizon Network.

3 ASCIANO'S DETAILED COMMENTS ON THE GAPE PRICING ISSUES RAISED IN THE AURIZON NETWORK DAAU

3.1 Nature of the GAPE System

Asciano notes that Aurizon Network (Supporting Submission page 11) implies that they are submitting the price change under the Aurizon Network Access Undertaking Schedule F Part B clause 4.1.2 which provides for the establishment of reference tariffs for new coal carrying train services. Under this clause the reference tariff is based on the incremental cost and Aurizon network argue that as the system is a new system (with no costs included in current reference tariffs) then all of the system costs are effectively incremental costs.

However Asciano understands from an operational perspective the GAPE does not appear to be operated as a stand alone system, (for example the system rules applying to the system are developed as part of the broader Northern Bowen Basin system rules and under the DAAU system reporting required by section 9 of the Access Undertaking does not apply to the GAPE).

Overall, Asciano is seeking clarity as to whether the GAPE is intended to be a stand alone system and if so is it a stand alone coal system for all purposes or only the purposes of reference tariff pricing.

More generally, with the development of the GAPE system, Asciano seeks a clear process for identification of services that consume capacity on rail infrastructure allocated to specific systems for the purposes of revenue recovery.

3.2 Contributions to Common Costs and Allocations between Coal Systems

The derivation of the GAPE reference tariffs does not appear to be consistent with the current Aurizon Network Access Undertaking.

A primary concern is centred on the ability of end users to be recognised in reference tariffs for their Private Incremental Costs. This has the potential to differentially treat users that have had mine specific infrastructure previously included in the asset base of other systems, in particular this approach may increase the effective access cost

for new entrants and as such reduce commercial competitiveness for these new entrants¹.

A further concern is that Asciano understands that the introduction of GAPE traffic at 50 million tonnes per annum² would reduce Goonyella system capacity from 81 million tonnes per annum to 72 million tonnes per annum³. This reduction is substantial. Asciano is concerned that GAPE traffic negatively impacts on existing Goonyella system capacity. This effectively penalises existing Goonyella system users as this system's reduced throughput must now be spread over the existing asset base potentially resulting in increased reference tariffs in the Goonyella system.

Asciano believes that Aurizon Network should provide further information on the impact of the GAPE on the Goonyella system and the QCA should consider the impact of this information in any decision on the DAAU.

In addition Asciano notes that the Supporting Submission (page 25) states:

“...the GAPE Reference Tariff will need to include an allocation of common operating and maintenance costs in subsequent regulatory periods to reflect the expected material increases in common costs associated with the loss of economies of scale inherent in a stand-alone Central Queensland Coal Region”

Asciano queries what the size of the losses of economies of scale in the regulated Central Queensland Coal network are expected to be and what the drivers of these losses are, and why users should have to pay for such costs, if for example they are due to increasing corporate overheads or are driven by factors outside the regulated coal network.

Further to this if forecast tonnages for the GAPE system are to recognise cross system costs then it could be assumed that economies of scale should be gained not lost, not lost and that the entire Central Queensland Coal region should benefit.

¹ Section six of the approved Aurizon Network Access Undertaking addresses issues relating to price differentiation. Aurizon Network should explain how the proposed reference prices and the use of private incremental costs are consistent with this section.

² Aurizon Network Supporting submission page 5 and page 7 indicate that this 50 Mtpa figure is possible

³ This capacity modelling result came from the ‘Integrated Logistics Company Pty Ltd Dalrymple Bay Coal Chain Master Planning Stage 2 Simulation Report dated 20 July 2011 Page 9

3.3 Clarity and Correctness of Assumptions

Capital Cost: The capital cost of the GAPE is not clear. In the Aurizon Network Supporting Submission the capital cost of the GAPE is variously referred to as:

- \$0.942 billion⁴ (including interest during construction);
- \$1.066 billion⁵ dollar project (excluding interest in construction); and
- \$1.237 billion⁶, (including interest in construction).

Where these latter two capital costs include capital improvements in the Goonyella and Newlands system (and where the northern missing link component is valued at between \$431 million and \$511 million). Asciano strongly believes that these differing valuations should be reconciled.

Given that the GAPE is being defined as a new coal system for pricing purposes the regulatory asset base of this system should be clarified and in particular the treatment of capital spent in the Newlands and Goonyella system and included the GAPE regulatory asset base should be further explained and quantified. In relation to this issue Asciano has concerns that capital costs may be inappropriately shifted between systems.

Further to the issue of the GAPE capital base Asciano notes that there are mechanisms in the Aurizon Network Access Undertaking (notably in Schedule A) which allow for adjustments to the amount of capital expenditure to be included in the asset base, particularly where the capital investment is determined not to be prudent then the capital need not be included. Asciano believes that the QCA should consider the GAPE capital base and the forecast volumes in the context of these Aurizon Network Access Undertaking provisions in order to determine whether the GAPE capital investment is prudent.

Return on Capital: The GAPE costs include an additional risk premium allowance. Asciano queries why such a premium is included in addition to the regulated WACC. The WACC for the portion of the GAPE that is not regulated should take into account any additional risks required to be reflected in the return on capital. The inclusion of

⁴ Table 15 on page 23 of the Aurizon Network Supporting Submission

⁵ Table 2 on page 13 of the Aurizon Network Supporting Submission

⁶ ibid

a separate risk premium in the regulated WACC opens the potential for Aurizon Network to be rewarded twice for bearing a risk.

To the extent that the risk premium allowance is intended to reflect self-insurance further evidence should be provided to support the size of the premium.

Incremental Operating Costs: On the issue of GAPE incremental operating costs, Asciano notes that GHD estimates of Aurizon Network's GAPE operating costs⁷ appear to have been escalated by CPI from 2007-8 to 2011-12. Asciano queries this approach as assumed volumes are different and the escalation approach used assumes that there have been no operating efficiencies obtained in the interim period (for example it assumes no operating efficiencies have arisen from the privatisation, technological developments, improved business and operating systems or management initiated efficiencies). Asciano queries if such an assumption regarding operating efficiencies is valid.

Further to this issue these operating costs appear to include functions such as a new train control board (Supporting Submission page 18) and additional planning, incident response, commercial and administrative staff. Asciano believes Aurizon Network should provide evidence that the train control board and additional staff were required before the costs for these activities are included.

Volumes: The Aurizon Network Supporting Submission makes various claims as to the GAPE volume including 50 million tonnes per annum (Supporting Submission page 5, page 7, page 8) and 33 million tonnes per annum as outlined below⁸:

“The long term volume scenario for new capacity created by the GAPE project, and committed under the GAPE and NAPE Deeds, is 33.0 Mtpa”

Asciano strongly believes that these differing volumes should be reconciled.

Asciano notes that the volumes being used in the development of the tariffs are lower than the volumes outlined above. Asciano is seeking clarity as to which volumes will be used in the long term to underpin GAPE tariffs. Asciano has concerns that higher

⁷ Table 8 of the Aurizon Network Supporting Submission page 18

⁸ Aurizon Network Supporting Submission page 12

volumes will not be attained given current and proposed pricing levels, and that such a volume shortfall is likely to lead to further upwards pressure on GAPE pricing in the near future which may further depress potential volumes.

Further to the issue of GAPE volume Asciano notes that a 160% Below Rail Transit Time constraint is proposed for the GAPE (this constraint is 124% in the Goonyella and Newlands system). Asciano queries whether such a high constraint is consistent with the 50 million tonnes per annum proposed for the GAPE. (This constraint is further discussed in section 4 below).

Stranding: The Aurizon Network Supporting Submission (page 14) notes that it considers that the GAPE has a higher stranding risk that is not reflected in the rate of return on capital or the GAPE reference tariff (which assumes a standardised risk profile for the Northern Bowen Basin).

Aurizon Network currently carries an asset stranding risk implicit in its regulated return. Asciano understands that the GAPE Deed arrangements clearly provide for a rate of return above this regulated rate of return, where this additional return must be due to additional risks being borne by Aurizon Network (including potentially a greater asset stranding risk). Thus any risk of asset standing is being compensated for by these additional returns. To the extent that Aurizon Network is taking on greater risk they are also receiving increased returns.

Asciano is seeking clarity on how Aurizon Network will address stranding risk in the GAPE reference tariffs in the longer term. Asciano's concern is that given the Aurizon Network rate of return already takes stranding risk into account then any additional adjustments to the GAPE reference tariff for stranding may be compensating Aurizon network for the same risk twice, resulting in GAPE users being disadvantaged.

Size of AT2 Tariff Component: Asciano queries the size of the AT2 tariff component in the GAPE system. The tariffs seems particularly high when compared with AT2 tariffs in other systems⁹, particularly when it is recognised that GAPE only allows smaller volume trains to operate and so per tonne rates are even higher.

⁹ For example Asciano estimates that the AT2 component is over 30% of the total access cost of a GAPE haul but would be approximately 10% of the total access cost of a Blackwater or Goonyella haul.

Electrification Costs: Aurizon Network (Supporting Submission Page 22) indicates that the GAPE capital cost includes electrification of passing loops in the Goonyella system and that these costs will be recovered through the AT3 tariff. As the GAPE is not electrified Asciano queries the inclusion of such electrification costs.

Asciano believes that recovery of Goonyella electric infrastructure costs would be more appropriate through Goonyella AT5 tariffs which are only paid for by trains which use this electric infrastructure.

Below Rail Transit Time Factor: Asciano notes that under DAAU Schedule F Part B clause 8.2 that the factor to be applied to the below rail transit time is 60 per cent of the section run times. Asciano believes that the quantum of this factor is too broad and provides minimal obligation on Aurizon Network to meet the below rail transit times for paths they have sold. If Aurizon Network is seeking to reduce the obligation on them to supply train paths of a given quality then there must be either reduction in the price they charge for these paths or an increase in penalties imposed for not meeting such a broad target.

4 ASCIANO'S COMMENT ON OTHER ISSUES RAISED IN THE AURIZON NETWORK DAAU

Asciano has concerns with the consequential amendments that relate to changes to the cross system pricing principles, the four part pricing system (i.e. AT1, AT2, AT3 and AT4) and reporting arrangements.

Asciano believes that the broader issues related to cross system pricing principles, the four part pricing system, GAPE pricing systems and pricing principles are better examined and finalised in UT4. Asciano notes that UT4 proposals have been submitted by Aurizon Network.

Asciano notes that clause 9.1 of the DAAU removes the obligation on the GAPE system to be subject to the system network performance reporting requirements that other Aurizon Network systems are required to meet (and for the purpose of reporting the GAPE system is to be treated as part of the Newlands system). Asciano believes that separate reporting requirements must apply to the GAPE; if the GAPE has separate tariffs then separate reporting is required to ensure Aurizon Network transparency.

Similarly, Asciano notes that clause 9.2 of the DAAU removes the obligation on the GAPE system to be subject to the system actual maintenance cost and system forecast maintenance cost reporting requirements (and for the purpose of maintenance cost reporting the GAPE system is to be treated as part of the Newlands system). Asciano believes that if the GAPE has separate tariffs then separate cost reporting is required to ensure Aurizon Network transparency.

Asciano has concerns with the unrelated amendments to 8.3 (f) of the Aurizon Network Access Undertaking relating to connecting infrastructure. Asciano recognises that the Aurizon Network re-drafting is an attempt to reflect the recent QCA Final Decision and Final approval relating to connecting infrastructure, however Asciano believes that a DAAU relating to GAPE reference pricing should be restricted to GAPE reference pricing. Amendments such as those 8.3 f) are best addressed either via either a separate DAAU relating to minor amendments or via the UT4 process which has recently commenced.

5 CONCLUSION

Asciano has major concerns with the proposed GAPE reference tariff approach including:

- the nature of the GAPE project being underpinned by specific commercial agreements raises concerns regarding:
 - inconsistencies between GAPE pricing and the access undertaking;
 - unjustified differential treatment of users; and
 - the potential for the specific commercial agreements to act as barriers to parties seeking access.
- the definition of the GAPE as an independent system creates concerns regarding the treatment of common costs and incremental costs. This concern related to the nature of the GAPE system is exacerbated by the treatment of GAPE as a stand alone system in some contexts but as part of the Newlands system in other contexts (such as network performance reporting); and
- the lack of clarity in the Aurizon Network supporting documentation in relation to GAPE volumes and GAPE capital cost, which are major determinants of pricing.

In addition the broader issues highlighted in relation to pricing systems and pricing principles should also be examined in the broader UT4 process.

Asciano is seeking that the concerns outlined in this submission be addressed before any GAPE reference tariffs are approved by the QCA.