Friday, 7 November 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
PO Box 2257
Brisbane Queensland 4001

By email: rail@qca.org.au

Dear Dr Roberts

Asciano Response to the Aurizon Network Submission on 2013-14 Revenue Adjustment Amounts and Increments to the QCA

Asciano welcomes the opportunity to comment on the Aurizon Network submission to the Queensland Competition Authority (QCA) on 2013-14 Revenue Adjustment Amounts and Increments (the submission). Asciano has several concerns with the submission as outlined below.

Background

On 31 July 2014, Aurizon Network sought approval from the QCA for revenue adjustments of $71.1 million to be reimbursed to access holders in the Blackwater and Goonyella systems in accordance with the provisions of Schedule F of the 2010 Access Undertaking. This over-recovery of revenue resulted from actual volumes being substantially higher than forecast volumes. No adjustments were proposed for the Moura, Newlands and Goonyella to Abbot Point systems. This was approved by the QCA.

Following this Aurizon Network July 2014 application a further application relating to revenue adjustments was made by Aurizon Network in September 2014. This September 2014 application includes claims for rebates and claims for increments which were not included in the July 2014 application. Asciano is treating this September 2014 submission as a separate regulatory process.

Asciano believes the claims for rebates and increments should be closely scrutinised by the QCA. Asciano does not support the claims for rebates and increments in the current submission.

Asciano Position on the Aurizon Network Proposed Treatment of Rebates

Asciano believes that the Aurizon Network submission's treatment of rebates in its revenue cap adjustment is inequitable for certain access holders.

As outlined in Aurizon Network's 2013 Draft Access Undertaking[1] the rebate adjustments are only made to the Total Actual Revenue (TAR) of 2010 Access Undertaking access agreements. This means that the TAR is adjusted for these rebates (including being adjusted for the difference between actual and forecast rebate payments) but the System Allowable Revenue (SAR) is not adjusted for rebates. This raises a number of issues as outlined below.

As 2013-14 actual volumes were substantially above forecast volumes Aurizon Network claim that they have overpaid rebates to holders of individual Access Facilitation Deeds (AFD). AFDs are commercial contractual financing arrangements that Aurizon Network has entered into with individual parties. Under an AFD the mine customer pre-pays capital and interest costs relating to mine specific infrastructure. Under an AFD Aurizon Network must then rebate the mine customer a return on capital and a return of capital for those assets. Thus the mine pays the reference tariff to Aurizon Network for access services and will then receive a rebate for the capital charges associated with the relevant infrastructure.

As a consequence of the actual volume and forecast volume mis-match. Aurizon Network is now seeking a recovery of overpaid AFD rebates via the revenue cap adjustment mechanism.

Asciano notes that only the TAR of the 2010 Access Undertaking access agreements is adjusted for rebates. The TAR of earlier access undertakings including the 2008 Access Undertaking access agreements are unaffected by the rebate adjustments as the revenue cap provisions of the 2008 Access Undertaking did not account for rebates. Given this Asciano believes that Aurizon Network should only consider rebates in the regulatory process when they relate to 2010 Access Undertaking access agreements.

The proposed Aurizon Network approach, which recovers rebates via the revenue cap

[1] Aurizon Network 2013 Draft Access Undertaking Supporting Submission Volume 2: The 2013 Undertaking Proposal p233

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adjustment, impacts all users and thus is inequitable for other users and access holders. In 2013-2014, as a result of Aurizon Network overpaying rebates, the 2010 Access Undertaking TAR was reduced (because the difference between the actual rebate payments and the forecast rebate payments was netted off the 2010 Access Undertaking TAR) leading to a revenue recovery claim by Aurizon Network.

However, the revenue recovery sought by Aurizon Network in the submission will be socialised across all users in the relevant system due to the operation of the system revenue cap adjustment framework. So even though 2008 Access Undertaking access agreement access holders are not subject to rebate adjustments (as the 2010 Access Undertaking TAR was not adjusted for rebates), they will be subject to the rebate adjustments applied to the 2010 Access Undertaking access agreements under the revenue cap adjustment framework.

Asciano believes that the proposed recovery of the rebates via the revenue cap adjustment mechanism is inequitable as it has the effect of socialising AFD risk to other users in the relevant system. Any rebates or adjustments should be managed directly with the individual party (including parties which have AFDs) rather than socialising the impact of these adjustments (whether they are positive or negative) over all other system users.

This treatment of rebates sets an incorrect precedent that may have negative impacts on take or pay arrangements for individual access holders.

Under the approach taken by Aurizon Network in relation to the treatment of rebates there is no transparency as to whether the forecast of the individual AFDs is consistent with the volume forecast applied to reference tariffs. In order to limit the potential of an AFD arrangement from financially gaining or losing the forecasts applied in the treatment of AFD arrangements should be consistent with the volume forecast applied to reference tariffs.

In addition there is no clarity surrounding how AFD assets are accounted for in Aurizon Network's asset base. The QCA should seek further information on the value and life of these assets and whether they are included in the existing regulatory asset base. An understanding of the valuation of the AFD assets will ensure there is no "double counting" related to Aurizon Network's treatment of these assets.

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Asciano Position on the Aurizon Network Proposed Treatment of Increments

Aurizon Network has sought to claim for increments in 2013-14 due to Aurizon Network's actual volumes significantly exceeding the forecast volumes in the Blackwater and Goonyella systems. Aurizon Network has taken the position that these higher volumes were largely achieved due to Aurizon Network activities, initiatives and capital projects. Aurizon Network has chosen to claim for the maximum 2 per cent increment of the AT2-AT4 tariffs as allowed for in the 2010 Access Undertaking. This increment allowance equates to approximately $8.9 million and, if approved by the QCA, will be applied in either 2015-16 consistent with the revenue cap arrangements in the 2010 Access Undertaking or as part of the finalisation of the 2014 Draft Access Undertaking.

Asciano believes Aurizon Network's claim for the increment is unsubstantiated. Section 3.3.1 (c), Part B, Schedule F of the 2010 Access Undertaking states that the QCA will consider this variation if they are reasonably satisfied that the difference between the TAR for AT2-4 and the SAR for AT2-4 for the individual coal system infrastructure has in whole or part arisen as a direct result of whole of coal chain activities or initiatives of Aurizon Network which have increased the efficiency of the below rail network. Asciano believes until proper measures such as KPIs are in place to objectively substantiate that Aurizon Network's activities increased the efficiency of the rail network then their claim for increments should be rejected by the QCA.

Although actual volumes were above forecast volumes, the contracted volumes were not achieved. Asciano believes that Aurizon Network would be in a stronger position in seeking increments if actual volumes were above contracted volumes (i.e. the volumes Aurizon Network is contractually obliged to deliver).

Asciano believes that any claim for increments should only be considered when actual volumes achieved are above contracted volumes (i.e. Aurizon network deliver an outcome greater than their contractual obligations). If this threshold is met then the claim for increments should be assessed using a KPI regime.

Asciano supports incentive and KPI regimes that drive increased efficiency in the supply chain. But until such incentive and KPI regimes exist it is difficult to assess whether or not Aurizon Network activities have increased efficiency on the network.

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Other Issues

Several other issues of concerns to Asciano are outlined below.

Level of Cost Information Available

It is difficult for Asciano to provide further detailed comment on the submission given the limited level of information disclosed in the submission. Current contractual arrangements result in much of the information underpinning the revenue-cap adjustment being confidential. This confidentiality limits the comments that can be made on the submission and reinforces the need for the QCA to be diligent in assessing the merits of the application.

Diesel and Electric Power Forecasting

Asciano has concerns regarding the forecast diesel and electric gross tonnes per kilometre in the Blackwater system. This forecast has a strong impact on the Aurizon Network recovery of the AT5 tariff, and as such Aurizon Network should make the forecasting approach and assumptions more transparent. Aurizon Network over recovered on AT5 revenue in both the Goonyella and Blackwater systems in 2013-2014.

Given previous Aurizon Network concerns regarding the ability of the AT5 tariff to recover costs, particularly in the Blackwater system, Asciano believes that the forecasting approach and assumptions relating to the electric and diesel split should be more transparent, (particularly in the Blackwater system).

Reliability of Forecasting

In recent years Aurizon network has either under-recovered or over recovered revenue by a substantial amount. For example in 2012-13 Aurizon Network under recovered revenue by $39.1 million whereas in 2013-14 Aurizon Network over recovered revenue by $71.1 million (as per the QCA approved Aurizon Network July 2014 application).

These fluctuations mean that within a given year users may not be paying the true cost of access and as such the allocative efficiency of the tariffs is diminished in the short term. In addition these fluctuations can create problems for miners and train operators in costing and planning their operations.

These substantial fluctuations in under recovery and over recovery are essentially attributable to differences between forecast and actual volumes. Asciano appreciates that forecasting is problematic, however these fluctuations indicate that there is scope for improvement in Aurizon Network's forecasting approaches. Asciano understands that in developing its regulatory forecasts Aurizon Network does not consult with either individual miners or train operators. Increased consultation with miners and train operators should result in improved forecasting and hence reduced levels of year on year tariff fluctuation.

Future Pricing Impact

Asciano is seeking that when the QCA and Aurizon Network implement tariff increases or decreases to address this revenue under recovery or over recovery that they do so in a manner which ensures that the tariff increases or decreases are only on those tariffs which have been under-recovered or over-recovered, and resist any potential for socialising the price adjustments over a broader range of tariffs.

Asciano believes that tariffs should be cost reflective to ensure productive and allocative efficiency. In particular, cost reflective tariffs are needed to ensure that there are no inter-fuel or inter system cross subsidies.

Conclusion

Overall Asciano is seeking that the QCA reject the Aurizon Network submission in its current form. Asciano is seeking that the QCA:

- adjusts any treatment of rebates to remove the socialisation of these rebates;
- only allows increments when actual volumes achieved are above contracted volumes and when a KPI regime is in place; and
- seeks improved transparency in Aurizon Network's forecasting approach.

If you wish to discuss this submission further please contact Ying Yeung (07 3002 3726) or Stuart Ronan (02 8484 8056).

Yours sincerely,

Geoff Featherstone
General Manager Strategy
Pacific National