



Asciano Submission to the
Queensland Competition Authority
in Relation to an Aurizon Network
Proposed Tariff for Train Services
to Wiggins Island Coal Export
Terminal

February 2015

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1 INTRODUCTION AND BACKGROUND

Asciano welcomes the opportunity to make a submission¹ to the Queensland Competition Authority (QCA) on the Aurizon Network proposal for access prices to take account of costs, revenues and volumes associated with the Wiggins Island Rail Project (WIRP) dated December 2014 (the Aurizon Network proposal).

This submission contains no confidential information and may be considered a public document.

Asciano Position

Asciano has previously provided comments on WIRP pricing to the QCA in its October 2014 submission on the Aurizon Network 2014 Draft Access Undertaking and continues to support the positions and principles that were put forward in that submission, and in particular continues to support a position that WIRP related infrastructure costs should not be socialised across Blackwater and Moura system users.

Asciano does not support the current Aurizon Network WIRP access pricing proposal as the proposal results in users who do not use WIRP related infrastructure having to fund this WIRP related infrastructure through the application of reference tariffs based on socialised costs.

Regulatory Process Issues

Aurizon Network submitted the current WIRP access pricing proposal separate to the 2014 Draft Access Undertaking (DAU) process; with the current proposal being under the 2010 Access Undertaking. Asciano is concerned that the issue of WIRP access pricing will be addressed as an access pricing issue separate to the 2014 DAU. Asciano believes that the WIRP access pricing should be considered as part of the 2014 DAU regulatory process. Asciano is seeking further clarity on the manner in which the proposed WIRP access pricing can be or will be incorporated into both the QCA decision making process on the 2014 DAU and the 2014 DAU itself.

Aurizon Network proposes to develop new reference tariffs, system allowable revenues and system forecasts inclusive of WIRP train services for the financial years 2015-2016 and 2016-2017. As part of this process Aurizon Network has had to

make assumptions regarding the escalation and the calculation of the individual tariff components as the QCA's draft decision on the 2014 DAU pricing and policy components was not released at the time of Aurizon Network's proposal. Asciano believes that it would have been more constructive if Aurizon Network waited for the QCA's draft decision to be released and then submit a proposal that more closely aligns with the QCA's draft decision. Such an approach would have facilitated the approval of WIRP reference tariffs as part of the 2014 DAU approval process.

In addition Asciano believes that the following matters must be finalised prior to (or concurrent with) any QCA final decision on WIRP access pricing:

- the expansion tariff process in 2014 DAU should be decided and should be consistent with the final decision on WIRP access pricing where appropriate;
- WIRP capital costs must be finalised. Aurizon Network notes (Aurizon Network proposal page 17) that capital costs associated with some WIRP projects have not been finalised at the time of the Aurizon Network proposal; these costs should be finalised; and
- the QCA should conduct a prudency review of the completed WIRP project segments. Aurizon Network notes (Aurizon Network proposal page 17) that the QCA will not have sufficient time to conduct a proper prudency review as per the access undertaking prior to first railings commencing for WIRP train services, which are expected in April June 2015.

2 OUTLINE OF AURIZON NETWORK WIRP PROPOSAL

The WIRP projects are a series of rail projects which have been undertaken to support the Wiggins Island Coal Export Terminal (WICET).The Aurizon Network proposal for WIRP access pricing is intended to take account of the additional rail infrastructure revenues, rail infrastructure costs and rail volumes associated with WIRP.

In preparing its submission, Aurizon Network only consulted with WIRP users who have contracted additional below-rail capacity to WICET. Asciano is concerned that no other parties, including existing users on the Blackwater and Moura systems railing to existing ports were consulted in the process. Given these users may be potentially impacted by Aurizon Network's proposal these users should have been consulted.

3 ASCIANO COMMENT ON THE AURIZON NETWORK PROPOSED ACCESS PRICING FOR WIRP

Asciano's comments on the proposed access pricing for WIRP are outlined in the section below.

3.1 Transitional Pricing

Asciano notes that WIRP train services are expected to commence in the period April – June 2015, and that Aurizon Network are proposing that these services pay the current Blackwater or Moura access tariffs but that these services will not be taken into account for the relevant system take or pay tests. Aurizon Network (Aurizon Network proposal page 5) note that once WIRP access tariffs have been finalised any over or under-recoveries arising from these tariffs will be addressed via an adjustment charge.

Aurizon Network should clarify how this approach will impact on the 2014-15 revenue cap assessment (presumably WIRP access revenues and volumes will not be included). On the basis that WIRP access revenue is not taken into account in the Blackwater and Moura regulated revenues then any additional WIRP revenue will be additional revenue for Aurizon Network. The regulatory treatment of this WIRP revenue in relation to Aurizon Network's revenue cap and the relevant system take or pay tests needs to be clarified in order to ensure that it does not negatively impact on existing users.

3.2 WIRP Volume Forecasts

Aurizon Network notes (Aurizon Network proposal page 3) that their consultation process with WIRP customers has resulted in an updated and independent volume forecast. Asciano questions the independence of this forecast as it was conducted by an organisation which previously prepared a report for WICET financiers containing mine production schedules and capacity allocations as part of the WICET Stage 1 development. The QCA should assess whether this volume forecast is genuinely independent.

The details of the volume forecast that Aurizon Network proposes to adopt (Aurizon Network proposal page 32) are redacted from the Aurizon Network proposal. Asciano understands there may be commercial and market sensitivities surrounding the release of such information, however by redacting the information stakeholders are prevented from assessing whether the proposed volume forecasts are reasonable.

Aurizon Network previously proposed to adopt a volume forecast at 90 per cent of the contracted WIRP train services². This forecast did not appear to fully address the ramp up profiles of new mines and a softening thermal coal market. Asciano is concerned that the revised volume forecast in this new Aurizon Network proposal may continue this forecasting approach.

3.3 WIRP Access Pricing Proposal

Socialisation of WIRP Costs

As stated in the introduction to this submission Asciano continues to support a position that WIRP related costs should not be socialised across Blackwater and Moura system users, however the Aurizon Network proposal takes the position that the WIRP related costs should be socialised across these users.

Asciano is concerned that socialisation of costs will result in existing non-WIRP users paying for infrastructure they do not need or do not use, with these non-WIRP users effectively subsidising WIRP users. Such subsidies are not cost reflective and result in inefficiencies. Consequently the QCA should closely scrutinise Aurizon Network's allocation of the WIRP related costs which Aurizon Network propose to allocate between WIRP and non-WIRP users. In Aurizon Network's previous WIRP pricing proposal¹ Aurizon Network proposed that an amount equivalent to one seventh of the total cost of the Blackwater duplications be allocated to existing Blackwater users, however based on the current proposal Aurizon Network has increased this allocation to 50 per cent of the Blackwater duplication costs without any independent evidence to support this increase. Asciano believes that such an increase must be carefully assessed by the QCA to ensure the prices are cost reflective and correct pricing signals are sent to the market.

In supporting its position Aurizon Network states (Aurizon Network proposal page 6 and page 8) that with the exception of the WICET balloon loop and a portion of the Moura West upgrades, projects included in the WIRP programme are fully integrated with the existing mainline infrastructure of the Blackwater and Moura systems. Based on this position Aurizon Network propose to treat the Blackwater duplications, Bauhinia North, North Coast Line and Moura East upgrades as mainline

infrastructure as they believe these will be utilised by both WIRP and non-WIRP users.

In arguing that these projects will benefit all users Aurizon Network (Aurizon Network proposal page 8) have stated that approximately 94 per cent of the capital value of WIRP relates to multi-user infrastructure and 70 per cent of the capital value of WIRP infrastructure will be utilised by non-WIRP users in the Blackwater and Moura systems. Asciano believes that Aurizon Network should outline how these figures were derived. It is difficult to assess the reasonableness of this position without understanding the derivation of these figures.

Asciano Concerns with the Aurizon Network Approach

Throughout its proposal Aurizon Network is inconsistent in the approaches taken in the development of the reference tariffs, and these approaches appear to have been selected to make the proposed reference tariffs appear more favourable to Aurizon Network. Some examples are outlined below:

- in the Blackwater system Aurizon Network have chosen to adopt the independent consultant's forecast whereas for the Moura system they have chosen to adopt their own forecast. These choices seem to lack consistency and appear to have the result of benefitting Aurizon Network;
- Aurizon Network proposes to defer a portion of the WIRP Maximum Allowable Revenue during the period of the 2014 DAU by applying a revenue smoothing factor (Aurizon Network proposal page 26). This approach does not seem to be consistent with the pricing approaches in the access undertaking and is inconsistent with how existing reference tariffs are derived. Asciano believes that any revenue smoothing approach will be problematic when forecast volumes are uncertain – given the start-up nature of WICET and current coal market conditions Asciano believes that these WICET volumes are relatively uncertain when compared to volumes in more established coal supply chains;
- Aurizon Network has been selective in choosing to use the pricing principles set out in Part 6 and Schedule F of the 2010 AU, rather than using the same provisions in their latest proposed 2014 DAU.
- Aurizon Network has adopted an inconsistent approach to how reference tariffs are applied. Aurizon Network proposes:
 - a Blackwater system reference tariff that is applicable to both WIRP and non-WIRP train services;

- a Moura system reference tariff that is applicable to WIRP and non-WIRP train services;
- a Moura system reference tariff that is applicable to WIRP train services which represents the incremental costs that these services pay (system premium)
- a North Coast Line reference tariff that is applicable to WIRP train services that originate from the Queensland Rail network.
- Aurizon Network's proposes to set the Contribution to Common Cost for WIRP users in Moura to nil. The Aurizon Network argument for this approach is that WIRP train services in Moura are subject to sufficiently high incremental costs. Blackwater WIRP customers will be subject to a Contribution to Common Cost in the Blackwater system.

Asciano believes that this Aurizon Network “cherry-picking” approach to the development of the proposed reference tariffs will shift risk from Aurizon Network to users. Furthermore Aurizon Network's proposal to socialise WIRP related costs to a broader group of users will result in these users carrying greater costs and risks and Aurizon Network risk being reduced as the recovery of the WIRP costs has been shifted to a broader user base.

Asciano Comments on Specific WIRP Projects

In relation to the WIRP projects identified by Aurizon Network Asciano argues the following.

Blackwater Duplication: Aurizon Network states (Aurizon Network proposal page 8) that the Blackwater system duplication projects were accepted by incumbent Blackwater system users as part of the 2008 Coal Rail Infrastructure Master Plan (CRIMP) and received scope pre-approval from the QCA. Asciano believes that this acceptance and pre-approval does not automatically identify the Blackwater duplications as prudent, noting that a proper prudency review as per the access undertaking is still to be conducted by the QCA (as stated in the Aurizon Network proposal page 17).

Aurizon Network (Aurizon Network proposal page 8) considers the full capital cost of the Blackwater duplications should not be treated as incremental costs (i.e. WIRP costs) as they believe that some (or all) of the duplications were still desirable in the absence of committed WIRP train services. Asciano disagrees with this position and

believes that all WIRP costs are incremental to WIRP train services as no new capacity for non-WICET ports has been developed and so any new capacity that has been required and developed is for WIRP train services.

Asciano has concerns regarding Aurizon Network's interpretation of incremental costs. The 2010 Access undertaking (2010 Access Undertaking page 141) defines incremental costs as:

... those costs of providing Access, including capital (renewal or expansion) costs, that would not be incurred (including the cost of bringing expenditure forward in time) if the particular Train Service or combination of Train Services (as appropriate) did not operate, where those costs are assessed as the Efficient Costs and based on the assets reasonably required for the provision of Access.

Asciano believes that the WIRP costs fit this definition as they are costs that would not be incurred if WIRP train services did not operate.

Asciano notes that the Aurizon Network (Aurizon Network proposal page 16) defines incremental costs as per the 2010 Access Undertaking. Aurizon Network (Aurizon Network proposal page 10) note that signalling upgrades have been brought forward due to WIRP; therefore by the Access Undertaking definition as cited by Aurizon Network these costs and all other similar costs should be treated as incremental costs not common costs.

The Aurizon Network position that the cost of the Blackwater duplications should not be treated as incremental costs is used to support Aurizon Network's socialisation of a proportion of Blackwater duplication costs to existing non-WIRP Blackwater users. Asciano believes a proper operational assessment should be provided by Aurizon Network which demonstrates that the benefits arising from the duplications flow through to non-WIRP users and are needed by these non-WIRP users.

Asciano believes that the Aurizon Network interpretation of incremental and common costs may impact on future transfer and relinquishment fees for Blackwater users; as if costs are not incremental then they must be common. This interpretation of incremental costs and its impact on transfer and relinquishment fees may in turn

have a significant impact on the flexibility and commerciality of existing user's underwritten capacity.

According to Aurizon Network, the Blackwater duplications were accepted by incumbent Blackwater users via the CRIMP process independent of the WIRP process. Given this it is unclear as to why Aurizon Network has sought to define these projects as WIRP projects and roll them into the current WIRP process. If these projects were justified separate to the WIRP project then they should not have been incorporated into this current WIRP regulatory process but into the broader Aurizon Network capital expenditure and access pricing regulatory processes. In summary the Blackwater duplications are either for current Blackwater users (despite the fact there have been no non-WICET port expansions) and so should not be in WIRP costs or are for WIRP users and so should not be included in Blackwater system costs.

Electrification: Asciano understands that electrification works were not part of WIRP Stage 1 for WIRP customers, although Aurizon Network has recently completed the electrification of the section between Rangal South and the Rolleston spur which is on the Bauhinia branch line³. Aurizon Network should clarify whether the WIRP Stage 1 expenditure forecast adopted in their proposed tariffs excludes electrification works such as the works outlined above. In particular Aurizon Network should clarify if electrification of the WICET balloon loop is intended to be included in the capital indicator outlined in the proposal (Aurizon Network proposal page 17).

Asciano notes that the WIRP capital indicator has increased (see section 3.4 of this submission). Asciano is seeking information on why the capital indicator has increased and in particular whether it increased due to the electrification of the Bauhinia upgrades or the Blackwater duplications (Asciano believes that any Blackwater duplications taken to user in 2008 would not have included electrification due to electric capacity issues that applied in Blackwater at this time. Given this any such electrification should not be included in the regulatory asset base).

Non-Capital enhancements: Aurizon Network (Aurizon Network proposal page 8) claim they have implemented a number of non-capital capacity enhancements as part of the WIRP program, resulting in increased pathing on the Blackwater system as a result of reducing train headways from 30 to 20 minutes. Asciano is seeking clarity as to why the non-capital costs of non-capital enhancements are being raised

in the current WIRP regulatory process which is in essence a process relating to capital costs.

Aurizon Network is seeking to recover the costs associated with these non-capital capacity enhancements from WIRP and non-WIRP users. Asciano is of the view that substantive evidence for such a claim must be provided for the QCA's assessment that includes the non-capital task conducted, the efficient cost incurred and the benefits realised by users, before any operating costs relating to this program are allowed to be recovered by Aurizon Network.

Asciano believes that non-capital related capacity enhancements should be considered as operational efficiencies that Aurizon Network should pursue as an access provider, consistent with the objective of Part 5 of the QCA Act "to promote the economically efficient operation of, use of and investment in significant infrastructure by which services are provided".

More broadly on this issue Asciano questions why this level of improvement has not been previously implemented in a period when capacity is constrained on the network, and furthermore, Asciano seeks that if these non-capital enhancements have achieved this increased pathing then these enhancements should be implemented in the Goonyella and Newlands systems if it is cost effective to do so.

Summary

Overall Asciano opposes the socialisation of WIRP costs as this will result in parties which do not use WIRP related infrastructure having to fund WIRP related infrastructure via the Aurizon Network access tariffs. This is inefficient and counter to the object of Part 5 of the QCA Act to "promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided".

3.4 Other WIRP Issues

Cost Increases

Asciano has noted a significant increase in Aurizon Network's forecast capital expenditure for WIRP projects. In Aurizon Network's 2013 DAU submission the total amount included in UT4 capital expenditure forecast for WIRP Stage 1 (i.e. all five segments) was \$910 million⁴. In Aurizon Network's current proposal the forecast has increased to \$945.3 million (Aurizon Network proposal page 17). Asciano believes

that this increase in capital expenditure should be explained, particularly as Asciano understands that capital costs for many projects are currently falling due to softer conditions in both infrastructure construction and export markets.

Pathing Increases

Aurizon Network notes (Aurizon Network proposal page 10) that the Blackwater duplication upgrades will increase the number of available train paths (from 48 to 72 paths per day in the Blackwater system, and from 48 to 96 paths per day on the North coast Line). Asciano understands that the “name plate” capacity in the Blackwater system pre-WIRP train services is currently 75 million tonnes per annum⁵. Aurizon Network should clarify the amount of paths required to achieve this baseline capacity (taking into account planned and unplanned maintenance). It is only after the pathing requirements to achieve the baseline capacity are established that Aurizon Network can assess the incremental capacity generated by the duplication upgrades. Asciano believes it is important that incremental capacity must relate only to the additional capacity generated above the baseline capacity.

In addition Asciano believes that the QCA should consider the timing of the Blackwater duplications and assess whether they were implemented earlier than required from a capacity requirement perspective. Such an assessment should be conducted under:

- a pre-WIRP scenario (prior to WIRP train services commencing) as this would confirm whether these duplication upgrades were required prior to WIRP; and
- a WIRP scenario (including WIRP train services).

Conducting the assessment under both scenarios will confirm whether the duplications were required in the absence of additional capacity created by WIRP.

4 CONCLUSION

Asciano does not support the current Aurizon Network WIRP access pricing proposal as the proposal results in users who do not use WIRP related infrastructure having to fund this WIRP related infrastructure through the application of reference tariffs based on socialised costs. More specifically Asciano is concerned with:

- regulatory processes surrounding the submission and approval of WIRP access pricing;

- transitional WIRP access pricing and its impact on regulated revenue cap processes and take or pay processes;
- the independence, transparency and appropriateness of WIRP pricing;
- the treatments of WIRP costs as common costs rather than incremental costs;
- the potential inclusion of electrification costs and non-capital costs into the WIRP cost base; and
- the level of WIRP capital costs.

Overall Asciano opposes the socialisation of WIRP costs as this will result in parties which do not use WIRP related infrastructure having to fund WIRP related infrastructure via the Aurizon Network access tariffs. This is inefficient and counter to the object of Part 5 of the QCA Act to “promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided”.

END NOTES

Endnote 1

In making this submission Asciano has not referred to the detail contained in the QCA Draft Decision on the pricing and policy components of the Aurizon Network 2014 Draft Access Undertaking which was released several days prior to the date of this submission

Endnote 2

Aurizon Network, Wiggins Island Rail Project Proposed Revenue and Pricing Treatment, August 2014.

Endnote 3

Article: <http://www.cqnews.com.au/news/new-system-first-in-nation/2487237/>

Endnote 4

Volume 3: Maximum Allowable Revenue and Reference Tariff 2013 DAU, 30April 2013, 8.3.1.6, Page 156.

Endnote 5

This is made up of 69mt at RGTT and 6mt at Barney Point as noted in section 1.3, page 12, AustCoal Consulting Alliance Client Briefing