

**Submission to the QCA on the QR
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 submission to the Queensland Competition Authority (QCA) in response to the QR 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 the 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.

This submission is public.

2 OUTLINE OF QR NETWORK DAAU

QR Network has submitted a DAAU which outlines proposed GAPE reference tariffs. QR Network is proposing to create an independent 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. In addition a revised Newlands system reference tariff is also proposed.

3 ASCIANO'S GENERAL POSITION ON THE GAPE PRICING ISSUES RAISED IN THE QR NETWORK DAAU

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

- QR Network has implicitly suggested that the existing conditions of the QR Network Access Undertaking are not a direct requirement in developing the

GAPE reference tariff. QR Network state in their supporting submission (page 11):

As QRNN 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 QRNN Undertaking.

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

- QR Network indicates (Supporting Submission page 3) that the GAPE project was underpinned by specific commercial agreements between QR 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 QR Network Access Undertaking; and
 - the GAPE system being priced in a manner which unfairly treats foundation customers vs non foundation customers (Asciano recognises that some differential treatment may be appropriate to the extent that foundation customers have assumed additional risk).
- QR Network's treatment of common costs in their approach. QR 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

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 QR 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.

- The DAAU supporting documentation should explicitly outline how the GAPE pricing approaches reconcile to the pricing principles contained in section six of the approved QR Network Access Undertaking.

4 ASCIANO’S DETAILED COMMENTS ON THE GAPE PRICING ISSUES RAISED IN THE QR NETWORK DAAU

Structuring of DAAU in Relation to the Requirements of the QR Network Access Undertaking

Asciano is seeking clarity as to the process by which QR Network is seeking to amend or introduce the GAPE reference tariffs. QR Network (Supporting Submission page 11) is clear that they are not submitting a tariff under the QR Network Access Undertaking clause 6.4.2, but it is not clear if they are submitting the price change under another section(s) of the QR Network Access Undertaking (such as Schedule F Part B clause 4.1.1 and 4.1.2).

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).

Overall, Asciano is seeking clarity as to:

- the process by which QR Network is seeking to amend or introduce the GAPE reference tariffs; and

- 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.

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 QR 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 entrants.

A further concern is that Asciano understands that that the introduction of GAPE traffic at 50 million tonnes per annum would reduce Goonyella system capacity from 81 million tonnes per annum to 72 million tonnes per annum¹. 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 reference tariff adjustments in the fully regulated Goonyella system. Asciano believes that the QCA should consider the impact of this in any decision on the DAAU.

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

¹ 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

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.

Clarity and Correctness of Assumptions

Capital Cost: The capital cost of the GAPE is not clear. In the QR Network Supporting Submission the GAPE is variously referred to as a \$0.942billion², \$1.066 billion dollar project (excluding interest in construction) and a \$1.237 billion project, including interest, where these costs include capital improvements in the Goonyella and Newlands system.

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.

Asciano recognises that QR Network has indicated that these issues will be further addressed in its 2011-12 capital expenditure claim to the QCA. Asciano is seeking for further clarity on the regulatory asset base and the treatment of the Goonyella and Newlands capital base in this documentation.

Further to the issue of the GAPE capital base Asciano notes that there are mechanisms in the QR 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 QR Network Access Undertaking provisions in order to determine whether the GAPE capital investment is prudent.

² Table 17 on page 24 of the QR Network Supporting Submission

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

Incremental Maintenance Costs: The GAPE incremental maintenance costs appears to be based on an approach which uses inputs from current coal systems. Asciano queries whether such an approach is valid as Asciano believes existing, mature coal systems may have different maintenance profiles and maintenance costs to a new coal system which to date has had only relatively small volumes of traffic. At the least Asciano believes the incremental maintenance costs should be justified by reference to a prudent maintenance program that could be expected in the first few years of a green-fields rail line, with light traffic.

Further to this issue Asciano believes that many of the maintenance costs identified in the QR Network's Supporting Submission (page 18) should not be required in the first few years of a green-fields rail line, with light traffic. For example rail grinding should only apply when a rail profile has been damaged by wear.

Fixed Maintenance Costs: The GAPE fixed maintenance costs (Supporting Submission page 16) appear to also be based on the fixed maintenance costs of existing systems. Again, Asciano questions whether such an approach is appropriate. At the least Asciano believes the fixed maintenance costs should be justified by reference to a prudent maintenance program that could be expected in the first few years of a green-fields rail line, with light traffic.

Incremental Operating Costs: On the issue of GAPE incremental operating costs, Asciano notes that GHD estimates of GAPE operating costs 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 QR National privatisation).

Further to this issue these operating costs appear to include functions such as a new train control board (Supporting Submission page 22) and additional staff. Asciano

believes QR Network should provide evidence of the additional planning, incident response, commercial and administrative staff required before the costs for these activities are included.

Volumes: The QR Network Supporting Submission makes various claims as to the GAPE volume including 50 million tonnes per annum (supporting submission page 5 and page 7) and 33 million tonnes per annum as outlined below:

“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” (QR Network Supporting Submission page 12)

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 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 from foundation GAPE users and non- foundation GAPE users alike.

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.

Stranding: The QR Network Supporting Submission notes that it considers that the GAPE has a higher stranding risk that is not reflected in the rate of return on capital (Supporting Submission page 14). Asciano is seeking clarity on how stranding risk will be addressed in the longer term.

QR 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 QR Network (including potentially a greater asset stranding risk). Thus any risk of asset standing is being compensated for. To the extent that QR Network is taking on greater risk they are also receiving increased returns.

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 systems, particularly when it is recognised that GAPE only allows smaller volume trains to operate and so per tonne rates are even higher.

Differential application of Reference Tariffs: Asciano seeks confirmation that all reference tariffs will be applied consistently with the relevant QR Network Access Undertaking.

QR Network (Supporting Submission Page 23) 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. Asciano believes that recovery of electric infrastructure costs would be more appropriate through AT5 tariffs which are only paid for by trains which use this electric infrastructure.

In addition Asciano seeks clarification of the intended origin for services utilising the GAPE system for the purposes of revenue recovery including a clear process for identification of services that consume capacity on rail infrastructure allocated to specific systems.

5 ASCIANO'S COMMENT ON OTHER ISSUES RAISED IN THE QR 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), the allowance of equity raising costs and reporting arrangements. In particular, at a minimum, separate reporting requirements must apply to the GAPE if the GAPE has separate tariffs and is a separate system. This separate reporting is required to ensure QR Network transparency.

Asciano believes that the broader issues related to pricing systems and pricing principles are better examined and finalised in UT4. Asciano expects UT4 proposals to be submitted by QR Network in the next two months so any delay is likely to be minimised.

In relation to equity raising costs Asciano queries the inclusion of wording to allow QR Network to determine an amount for equity raising costs. Asciano recognises

that equity raising is not costless but believes that to the extent equity is actually raised it is raised by QR National and the costs of such equity raising are passed through to QR Network via an allocation of overheads (i.e.; allocation as per the Costing Manual). If equity is actually raised to fund construction of a substantial capital project then the costs of such equity raising should be considered for capitalisation in the asset base, but if no equity raising occurs then no costs should be capitalised into the asset base.

Asciano notes that the definition of review event has been amended to include a volume increase in GAPE and Newlands traffic. Following such an event QR Network can seek a tariff variation. However, QR Network has indicated (Supporting Submission page 30) that they intend to seek higher allowable revenues in the event that volumes increase rather than seek to lower prices. Asciano recognises separate commercial arrangements have been made with foundation customers but queries why higher regulated revenues should be allowed to be recovered in the GAPE and Newlands system. Asciano believes that if a revenue cap regulatory approach is used then any increase in volumes (without further capital investment) should result in a relative price reduction. If QR Network wishes to increase its revenue in line with increases in volumes it should move to a price cap regulatory approach.

Asciano has concerns with the unrelated amendments to 8.3 (f) of the QR Network Access Undertaking relating to connecting infrastructure. The re-drafting of this clause has substantially changed the intent of how QR Network recovers costs associated with connecting infrastructure, as the amended clause now states that costs will be recovered by QR Network via a separate agreement with the owner of the private infrastructure. Asciano understands that the QCA is likely to release a Final Decision on the issue of connection agreements. Asciano believes that this is the most appropriate forum for raising concerns with QR Network Access Undertaking clauses relating to connection infrastructure and the funding of such connections.

6 CONCLUSION

Asciano has major concerns with the proposed GAPE reference tariffs and include:

- the reference tariff derivation and application must adhere to the QR Network Access Undertaking, except where it is explicitly recognised that the access undertaking does not apply;
- the treatment of common costs;
- consistency of treatment across systems and users;
- clarity in regard to the capital asset base used;
- clarity in regard to the volumes assumed;
- the appropriateness of the maintenance costs, operating costs and risk premium allowance assumed;
- the appropriateness of allowing an equity raising cost;
- the need for separate GAPE reporting requirements;

In addition the broader issues highlighted in relation to:

- pricing systems and pricing principles are better examined and finalised in UT4. and
- connection agreements and procedures are better examined and finalised in current QCA processes relating to connection.

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