QUEENSLAND resources COUNCIL

Resourcing Queensland's future

1April 2021

Mr George Passmore
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane QLD 4000
(submitted via QCA Online Submission Form)

RE: Aurizon Network Annual Review of Reference Tariffs – FY23

The Queensland Resources Council (**QRC**), on behalf of the QRC's Rail Working Group, welcomes the opportunity to comment on Aurizon Network's Annual Review of Reference Tariffs – FY23.

1. System Forecasts

We welcome the forecast methodology adopted by Aurizon Network for the FY23 Annual Review of Reference Tariffs (ARRT). The methodology is largely consistent with an approach suggested by the QRC Rail Working Group in previous submissions, which involved:

- A base forecast for each origin/destination pair derived from annualised performance in the current year (in this case, FY22).
- Considering feedback from customers on any expected material changes between the annualised FY22 forecast and expectations for FY23.
- Aurizon Network exercising judgements regarding the extent to which variations from the FY22 forecast, suggested by customers, should be adopted. We note that Aurizon Network developed some principles for this decision. We found the description of those principles within Aurizon Network's submission confusing. Aurizon Network has since clarified the approach, which we understand to be:
    - If the forecast provided by Customers exceeded both the contract volume and the annualised forecast, Aurizon Network applied the maximum of contract volume or the annualised forecast;
    - Otherwise, Aurizon Network applied the volume forecast provided by the Customer.
    - Where the Customer did not provide a forecast, the lesser of contract and annualised FY22 performance was applied.

We are comfortable with the approach taken and with the resulting forecasts. The methodology improves on previous years because:

- It involves greater consideration of customer input; and
- The previous approach involved developing a tonnage forecast for each system, then allocating that tonnage to origin-destination pairs based on contract. The new method involves developing both the tonnage forecast and the gtk forecasts from origin-destination forecasts. This is likely to lead to a more realistic conversion of the tonnage forecast to a gtk forecast.

We appreciate Aurizon Network's efforts to consider our suggestions regarding the forecasting methodology.

2. Allowable Revenue adjustments

Aurizon Network's submission shows the total proposed Allowable Revenue adjustments within each system and provides information on the causes of adjustments. The contribution of some of the adjustments to the total proposed adjustment within a system is disclosed, while the impact of other adjustments is not provided. For example, the effect on Allowable Revenue of the adjustment to the FY23 Capital Indicator (table 17) is not provided. Tax adjustments are also not quantified. For future ARRT submissions, the QRC would appreciate the inclusion, for each system, of a reconciliation or waterfall chart showing the value of each adjustment. We understand that the value of an adjustment could vary depending on the order in which the adjustments are performed but would find this information useful regardless of this consideration. Aurizon Network has provided this information to QRC at a network level for the proposed FY23 adjustments.

3. Capital Expenditure Allowable Revenue Adjustments

We rely on the QCA to verify Aurizon Network's calculations of the FY21 capital expenditure Allowable Revenue adjustments.

QRC has sought information from Aurizon Network on how the $35m variance between FY21 Capital Expenditure and the capital indicator (table 12) resulted in a $46.8m adjustment to Allowable Revenue (table 13). Based on responses from Aurizon Network, our understanding is that:

- Most of the variance is caused by the capitalisation of APS in FY21.
- APS expenditure dates back many years and the value of each year's expenditure has been escalated at the WACC.
- Aurizon Network proposes a three year-asset life for APS, commencing FY21. Therefore, the entire escalated value of this asset ($60m in FY21) will be written off in FY23.
- The impact of this adjustment, comprising WACC adjustments, the full value of the asset, and associated tax adjustments, is having a material impact on Allowable Revenue and Reference Tariffs for FY23.

We have a number of concerns with this situation:

3.1 Inappropriate asset life

The QRC considers it inconceivable that APS could be considered to have a useful life of only three years. If APS and the associated systems did have a three-year life:

- The QCA ought to have found that the expenditure was not prudent.
- Aurizon Network would need to be investing significant funds during FY22 and FY23 to develop replacement systems. Nothing in the MRSBs indicates that this is happening.

We note that Aurizon Networks capital expenditure claim, in regard to APS, discusses '*interim benefits realisation analysis*' (Section 10.2.3). Aurizon Network comments that *"it is not uncommon for the benefits of ICT projects to take time to fully realise (indeed the Australian Energy Regulator's Non-Network ICT Capex Assessment Review noted that the benefits of an ICT project may not become apparent until several years after the investment)"*. These comments are consistent with ATS being (as at FY21) in the early stages of achieving its objectives. It cannot be the case that, by the end of FY23, the asset will have reached the end of its useful life.

We also note that Aurizon Network's capital expenditure claim describes the systems being replaced by APS as "*legacy planning and scheduling systems*". The term "legacy", when used by Aurizon Network, generally refers to aspects of the Aurizon business as they were prior to privatisation (i.e. prior to 2010). Therefore, it seems that the systems being replaced were in use for more than a decade. We would expect the same from APS.

We request that the QCA approves an asset life for APS which reflects the period over which the system is expected to be in place. Our expectation is that a system replacement of this scale would generally occur no sooner than a decade after the previous replacement, therefore we suggest a minimum asset life of ten years.

3.2 Lack of transparency/communication

QRC and its Rail Working Group members were disappointed that an adjustment of this magnitude (impact of $60m+) could be proposed without significant consultation and notice. Aurizon Network's communication and consultation with the Rail Industry Group, regarding the development of the MRSB, has improved significantly over the past year and has now developed into constructive and valuable engagement. The Rail Working Group would welcome similar engagement on regulatory matters, including being provided with draft submissions sufficiently ahead of lodgement to allow feedback to be provided and considered.

We also seek greater transparency regarding capital expenditure which has been incurred but not capitalised. A format similar to Figure 1 from Aurizon Network's FY21 Capital Expenditure Claim (shown below), if provided for each system, may be

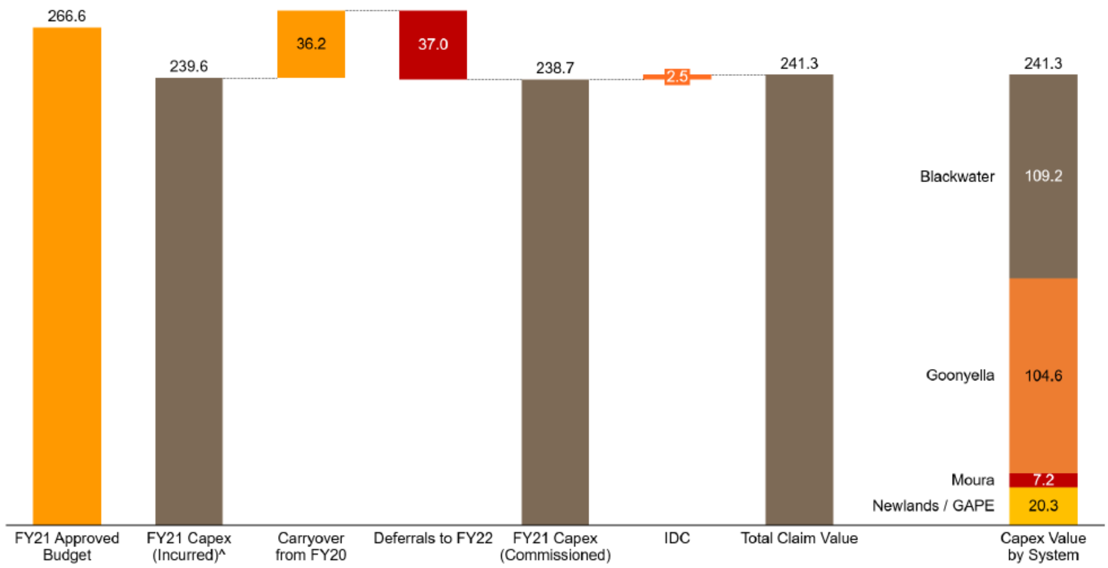
ABN 59 050 486 952
Level 13 133 Mary St Brisbane Queensland 4000
T 07 3295 9560 F 07 3295 9570 E info@qrc.org.au
www.qrc.org.au

sufficient, provided that:

- the 'carryover' and 'deferrals' numbers capture carryovers and deferrals from all previous years, not just from the current year's renewals program. This may already be the case, but this is not clear from the descriptions.

- the 'deferrals' numbers should be split by year of expenditure. For example, 'deferrals of FY21 expenditure', 'deferrals of FY20 expenditure' etc. As we have seen from the APS case, the length of time over which expenditure has been deferred can have a significant impact on the total capital value and the size of adjustments.

Figure 1 FY21 Renewals Program



4. Transmission Network Service Provider (TNSP) charges

QRC Rail Working Group members have sought an explanation of the large increase in TNSP costs in Blackwater (20%, despite a reduction in volume forecasts). This is particularly surprising given the significant reduction in TNSP costs in Goonyella. Aurizon Network has been unable to provide any explanation, due to confidentiality constraints. This is surprising given Aurizon Network's comment that these charges "*are determined in accordance with an established regulatory framework*". We rely on the QCA to review these costs. We also request that the QCA considers the confidentiality constraint and the extend to which some context for the changes could be provided, such as a description of how the regulatory framework operates, and of the factors which can lead to changes in costs (and to such changes moving in opposite direction between two systems).

5. Electric Energy Charge

We rely on the QCA to assess the prudency of the Electric Energy charge. Aurizon Network has, as the submission states (page 18), "*engaged with customers to determine future options relating to electricity, including Green Energy within the Electricity Charge*". This consultation occurred when Aurizon Network's procurement process was well advanced. Customers were unable to provide any meaningful feedback within the time available prior to Aurizon Network making final decisions. We look forward to more effective consultation in the future.

6. Newlands/GAPE allocations

This issue remains outstanding and is the subject of ongoing engagement between Aurizon Network and relevant customers. QRC remains of the view that the current approach allocates an unreasonable proportion of renewals costs to Newlands customers. We also note that, in the absence of retrospective adjustments, each year which passes without the issue being resolved effectively locks in further costs for Newlands customers.

7. Regulatory asset life for Ballast

QRC supports Aurizon Networks proposed eight-year life for ballast undercutting renewals.

We note that the decision to capitalise these costs under UT5 had the (perhaps unintended) effect of shifting a cost which was previously shared between Newlands and GAPE customers to Newlands customers alone (under Aurizon Network's current approach to pricing). This is relevant to consideration of the Newlands/GAPE allocation question.

Thank you for the opportunity to provide this submission.

Yours sincerely

Andrew Barger

ABN 59 050 486 952
Level 13 133 Mary St Brisbane Queensland 4000
T 07 3295 9560 F 07 3295 9570 E info@qrc.org.au

www.qrc.org.au