

# **SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY**

## **AURIZON NETWORK'S PROPOSED TREATMENT OF THE WIGGINS ISLAND RAIL PROJECT (WIRP)**

**FEBRUARY 2015**

## 1. Executive summary

Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes the opportunity to make submissions to the Queensland Competition Authority (**QCA**) in respect of Aurizon Network Pty Ltd's (**Aurizon Network**) treatment of the Wiggins Island Rail Project (**WIRP**) in relation to proposed transitional Reference Tariffs for the Blackwater and Moura Systems.

As acknowledged by Aurizon Network in its latest proposed new Reference Tariff submission of December 2014, as a non WIRP User Anglo American has not been consulted about the proposal prior to lodgement with the QCA.

Anglo American believes that Aurizon Network has based its submission on volume forecasts that may be unreliable. Importantly, Anglo American believes that these include forecast tonnages which will not necessarily be achieved through WIRP, a concern that has also been expressed by Anglo American and other industry participants on previous occasions.<sup>1</sup>

Although it is not entirely clear, Anglo American understands that Aurizon Network's current intention is to socialise 50% of (either the total or duplication) costs relating to WIRP enhancements to the Blackwater System across all users. In light of the history of the various representations made by Aurizon Network in previous related regulatory processes, Anglo American believes that, in addition to the WIRP specific enhancements, the entire Blackwater duplications were solely undertaken for the purposes of WIRP. In the absence of any visibility on the forecast volumes being relied upon, Anglo American is unable to form a view and therefore make submissions as to whether the potential socialisation of any of these costs may, or may not, negatively impact on the non-WIRP producers in the Blackwater system based on those volume forecasts. Anglo American suggests that in respect of Blackwater the QCA adopts the 'no worse off' approach as discussed further below.

In respect of the Moura System, Anglo American is not entirely sure of the basis or the proposal being put forward by Aurizon Network. However, it would support an approach, to the extent that seems to be advocated, that there is no socialisation of costs until such time as there is full utilisation, by way of actual volumes, which allows socialisation of the related costs to therefore lower the overall Reference Tariff for the Moura system. However, Anglo American objects to the proposal to the extent that it advocates for a position that WIRP Moura producer should not pay any minimum contribution to common costs (**CCC**). This is inconsistent with the fundamental premise of the Access Undertaking and Anglo American

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<sup>1</sup> For example, see Vale, *Aurizon Network's 2014 Draft Access Undertaking (UT4)* (3 October 2014); Queensland Resources Council, *Aurizon Network's draft 2014 Undertaking: Main Submission* (3 October 2014) 66; BHP Biliton Mitisubishi Alliance, *Aurizon Network's 2014 Draft Access Undertaking* (3 October 2014); Asciano, *Submission to the Queensland Competition Authority in Relation to the Resubmitted 2014 Aurizon Network Draft Access Undertaking* (October 2014) 56.

does not consider that having to pay a CCC, which it should, will affect the competitiveness of the WIRP Moura producer.

## 2. Consultation process

Anglo American notes the consultation section on page 3 of the Aurizon Network "Proposed New Reference Tariff for Train Services to Wiggins Island Coal Export Terminal" (**Aurizon Paper**) states that Aurizon Network has consulted with the WICET customers as part of the development of the Reference Tariff.

In light of the fact that the Aurizon Paper advocates for socialisation amongst users who are not WICET customers, it would seem to Anglo American that the consultation process undertaken by Aurizon Network to date is flawed. Those customers who may be financially impacted should be given a proper opportunity of consultation and to properly understand the basis for the proposal.

## 3. Socialisation

Anglo American has previously expressed the view on a number of occasions that socialisation is appropriate in some cases and should be considered on a case by case basis. It remains of this view.

In respect of WIRP, there are a number of circumstances in relation to the proposal giving rise to Anglo American objecting to a general proposition for socialisation across non-WIRP users of the Blackwater and Moura Systems, particularly given the history and inadequate information provided to understand the basis and application for such a proposal.

Firstly, Anglo American objects to the use of the CRIMP process as justifying socialisation on the basis that the duplications were not solely required for WIRP. Anglo American understands that the history of representations made by Aurizon Network as to whether the duplications were or were not required for WIRP is as follows:

- (a) **2008 CRIMP:** During the 2008 CRIMP process Aurizon Network produced modelling which demonstrated that duplications were required with, or without, WICET. The producers took this at face value and either endorsed or (by not voting as it was unclear as to the requirement) were deemed (by the then CRIMP process) to have endorsed the projects. As the QCA is aware, the implications of this course of conduct was that the customers "endorsed" the capital expenditure as prudent, assuming it was necessary and reasonable, and in the ordinary course of business, with the upgrades then not proceeding as proposed, at Aurizon's complete discretion;

- (b) **Access Conditions process:** Aurizon Network then (subsequently sought Access Conditions from WIRP users and) produced modelling which demonstrated that the projects were not required in the absence of WICET. Anglo American was not a WIRP producer and was excluded from the negotiations of the WIRP Deed. However, one assumes that the WIRP producers accepted the modelling and the inclusion of the duplications as WIRP related upgrades;
- (c) **QCA approval process:** On 25 May 2012, the QCA approved the Access Conditions. Page 1 of the QCA Decision reflects the application of Aurizon Network and clearly identifies the upgrades as being required for the purposes of the WIRP Project; and
- (d) **Current process:** Aurizon Network now states that the some of the duplication works were required for existing users. In its original August 2014 paper it considered that the allocation should be 1/7th with the latest Aurizon Paper from December now (it seems) seeking to allocate at least 50% of those enhancements to non-WIRP customers.

The Aurizon Paper references a letter from the Gladstone Coal Exporters Executive (GCEE) dated December 2010 requesting urgency for the duplications to be done. Anglo American does not believe that this is relevant as neither the context of the letter nor the basis for the knowledge of the GCEE giving rise to the letter is known or clear. To the knowledge of Anglo American there was no subsequent process identifying the reasons for the need of the duplications nor discussion of who should fund the duplications. When there is such significant information asymmetry between the parties, a mere reference in a letter by the producers to the duplications cannot be read as any form of admission or representation by the users as to why the works were perceived to be needed nor who should fund them.

Anglo American does not see any clear evidence that the duplications were required for existing users. Indeed, the access condition process modelling suggests that they were all required for WIRP producers. Anglo American is firmly opposed to the QCA taking at face value that 50% of these costs is an appropriate basis for such costs to be socialised amongst all users. There is no reliably clear evidence to support this and Aurizon Network has made no attempt to justify nor explain how things may have changed since the access conditions process.

It appears from the latest Aurizon submission that allocation of 50% of the duplication costs to Blackwater users artificially inflates the future Blackwater Reference Tariffs, which are then used as a unit rate in \$/NTK (p.14, figure 2) to benchmark the incremental pricing of WIRP services. The Aurizon proposal concludes that incremental pricing of WIRP

Blackwater is lower than the future non-WIRP Blackwater Reference Tariffs and that these later Tariffs should therefore apply. This gives the effect of socialising all WIRP Blackwater infrastructure with existing Blackwater users and the fortuitous appearance of lower Tariffs for existing users. However, Anglo American suggests that this pricing is misleading as future non-WIRP Blackwater Reference Tariffs would actually be much lower, due to exclusion of all (or most) of the Blackwater duplication costs. It is therefore also likely that the WIRP Blackwater Tariff (based upon incremental WIRP costs and minimum CCC) will actually be higher than the future non-WIRP Blackwater Tariff, with resultant non-socialisation of costs.

Another important issue for consideration in this context is, aside from whether socialisation is appropriate on the basis of capacity expansion allocation, if the volumes being relied upon to present a case for lower system tariffs overall do not eventuate or the WIRP users that may be required to pay TOP to ensure the SAR is met are unable to pay, the effect is that existing users will have had Aurizon Network's cross default risk transferred to them.

#### **4. Forecasts**

Aurizon Network has relied on volume forecasts provided by John T. Boyd Company for WICET. All of the relevant information has been redacted. Anglo American believes that certain aggregated information can and should be made available such that the volume forecasts upon which Aurizon relies to justify the latest proposal can be understood and assessed. If it is not, then stakeholders including non WIRP Users which are being asked to consider bearing socialisation of costs on the basis of these forecast volumes, are unable to form a view and make proper submissions as to whether they believe the forecasts are reliable or not.

Importantly, if the forecasts are inflated then it will seem that the inclusion of WICET volumes will reduce tariffs. If the volume does not eventuate then 'Take or Pay' (TOP) may be more easily triggered and all users in the relevant system(s) will be exposed to the risks associated with lower than anticipated WICET volumes and default on the part of one or more WIRP producers.

#### **5. Suggested approach in the Blackwater system**

In the present circumstances there is no clearly reliable evidence before the QCA that the duplications were required to deliver contracted capacity for existing users. No access to the forecast information being relied upon, nor a clear basis for the calculations or other information used to support the proposal, means that Anglo American is not in a position to assess whether access charges are likely to be positively or negatively impacted. It has no

choice but to submit that in these circumstances the QCA should adopt the 'no worse off' position which has been advocated by some in the industry, being:

- (a) unless the QCA can be satisfied, via independent review, to form a conclusion that it is likely that the future Reference Tariff for non-WIRP Blackwater users (post introduction of WICET and with the exclusion of the Blackwater passing loops) will be reduced then socialisation to that extent should occur;
- (b) however, if the QCA cannot form the view that the future Reference Tariff for non-WIRP Blackwater users (post introduction of WICET and with the exclusion of the Blackwater passing loops) will be reduced, then it should require that the cost of the duplications be allocated to WIRP producers as part of the expansion tariff. It may be appropriate for subsequent socialisation to occur for example, where the incremental volumes eventuate to reduce the overall system tariffs.

## **6. Impact on Moura System**

As the major user of the Moura System, Anglo American notes that its operations stand to bear a significant portion of any Reference Tariff change imposed on the Moura System by virtue of the proposed socialisation of Moura WIRP costs or alternate pricing methodologies proposed outside of the guidelines of the Undertaking.

The Aurizon Paper is not entirely clear as to what is precisely intended in respect of the Moura System. On Anglo American's reading, Aurizon Network intends the following:

- (a) The WIRP producer on the Moura System does not pay any minimum contribution to common costs (CCC);
- (b) That the WIRP related costs are not socialised into the Moura System for financial years 2016 and 2017;
- (c) The WIRP producer will pay a System Premium under Part B, Schedule F for financial years 2016 and 2017. Although, it is not entirely clear whether Aurizon Network intends that the System Premium will continue after 2017 or whether it believes that WIRP Moura volumes will reach full utilisation in 2018 and that therefore the costs will be socialised into the system costs; and
- (d) Once WIRP Moura volumes reach full utilisation it might be socialised through the mechanism of amending the Annual Review of Reference Tariffs.

If it has understood correctly, Anglo American generally agrees with this aspect of the proposal to the extent that it seems to endorse the approach of incremental pricing and no

socialisation (or at least no socialisation until full utilisation at which time socialisation would result in a lower overall Reference Tariff). However, Anglo American strongly opposes the proposal where the WIRP Moura producer does not pay a minimum CCC towards Moura system costs. The concept of CCC was built into the Access Undertaking for the purposes of avoiding 'free-riding'. This is the presumption set out in section 4.1.1 of Part B of Schedule F. There is no basis for Aurizon Network to conclude that requiring the WIRP producer to comply with section 4.1.1 of Part B of Schedule F has the effect of 'significantly distorting competition in the market' and it is considered that existing Moura system users are actually being asked to cross subsidise new users of the system. The decision of the QCA in respect of Colton to Barney Point Alternative Access Charge is not an appropriate precedent as that case involved the use of only approximately 8 kms of the Aurizon Network's rail infrastructure.