



Mr Charles Millstead  
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Queensland Competition Authority  
Level 27, 145 Ann Street  
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## CONFIDENTIAL

### 2017 Draft Access Undertaking – Revision to the Proposed Averaging Period

8 May 2018

Dear Charles

#### *Purpose of letter*

The purpose of this letter is to revise the averaging period initially proposed by Aurizon Network for the 1 July 2017 to 30 June 2021 regulatory term (**UT5**).

#### *Communication without prejudice to judicial review proceedings*

This communication is without prejudice to the judicial review proceedings filed by Aurizon Network on 30 April 2018 and is provided to the QCA against the possibility that the QCA does not restart the decision making process for UT5 under a new Chair or a Court does not make the orders sought in the application. This letter should therefore be read in the context of the proceedings and Aurizon Network's letter to the QCA in connection with the judicial review proceedings dated 1 May 2018.

#### *Background to averaging period issue*

Aurizon Network wrote to the QCA on 13 February 2017 proposing a market averaging period of 20 business days from 2 June 2017 to 30 June 2017 (**proposed averaging period**) for the determination of market parameters associated with estimating the cost of capital and inflation for the UT5 regulatory term on the premise that a decision for the UT5 regulatory period would be made prior to the commencement of that period. The UT5 regulatory period extends from 1 July 2017 to 30 June 2021.

The QCA responded on 10 March 2017 indicating that it was:

*favourably disposed towards the 20 business days ending 30 June 2017 to be used as the averaging period for determining the time sensitive parameters for Aurizon Network's 2017 DAU<sup>1</sup>.*

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<sup>1</sup> <http://www.qca.org.au/getattachment/10f9384b-6484-4693-89c8-80e1c14737e1/QCA-response-to-Aurizon-Network-s-proposed-UT5-ave.aspx>

Importantly, as part of that correspondence, the QCA did not provide any indication that the QCA was not expecting to release its Draft Decision on UT5 prior to the nominated averaging period.

The UT5 Draft Decision (**Draft Decision**) was published on 15 December 2017.

In the absence of a draft decision prior to the nominated averaging period, Aurizon Network considers that the initially proposed averaging period is no longer appropriate. This is for two main reasons as set out below.

First, in order for Aurizon Network to properly consider what steps it may be prudent to take to manage potential risks (for example, by way of hedge contracts or other risk management instruments), it is essential that the averaging period (being the period in which risk management strategies would be put in place), occurs after the Draft Decision. This is because it is the Draft Decision document that signals the QCA's intended approach to significant matters including inflation and the return on debt. That is, the content of the Draft Decision informs Aurizon Network's assessment of what, if any, financial risk management strategies would be prudent to implement during the averaging period in light of the approach the Draft Decision indicates will be adopted to revenue-critical parameters.

Second, a period closer to the making of the final decision should be used because such a period will, all else being equal, contain better or more up-to-date information as to the conditions expected to prevail over the regulatory period. That is, assuming that the QCA will make a final decision around [REDACTED] contains better information about the conditions likely to prevail over the regulatory period than a period [REDACTED]. In this regard, the June 2017 averaging period does not provide a good indication of the market conditions likely to be experienced over the regulatory period. This is evident in:

- a reduction in BBB spreads over the 10 year CGS as evident in Table F3 of the Reserve Bank published statistics;
- an increase in the nominal risk free rate with a corresponding increase in the break-even inflation rates; and
- an increase in the nominal yield from 2.51% in June 2017 to 2.83% in Feb 18 in relation to the period from 28 February 2018 to 30 June 2027.<sup>2</sup>

Measuring parameters during a period that is likely to be more reflective of the market conditions that will be experienced over the regulatory period:

- promotes the object of the *Queensland Competition Authority Act 1997* (Qld) as set out in section 69E (in particular economically efficient investment in infrastructure);
- is appropriate having regard to the factors set out in section 138, including:
  - the legitimate interests of Aurizon Network and access seekers; and
  - the pricing principles in section 168A, most relevantly, that the price of access should generate expected revenue for the service that is at least enough to meet the efficient costs of providing access and include a return on investment commensurate with the regulatory and commercial risks involved.

*Revision to the proposed averaging period*

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<sup>2</sup> Aurizon Network analysis of term structure of indicative mid-rates of AGS, Table F16 in RBA Statistics

This period is:

- consistent with the expected statutory timeframes for the making of a final decision on UT5<sup>3</sup>; and
- sufficiently in advance of the notification period to expose Aurizon Network to both favourable and unfavourable movements in market parameters (that is, to be unbiased).

If it becomes evident to the QCA that the Final Decision is likely to occur more than 30 days beyond the nominated market averaging period then Aurizon requests that the QCA:

- notify Aurizon Network at least 20 days prior to the commencement of that period; and
- allow for further revision of the averaging period to account for the revised expectations for issuing a Final Decision.

Aurizon Network requests that:

- the QCA indicate whether it is favourably disposed to the averaging period being determined in accordance with this letter (in order that Aurizon Network can review any risk management strategies that might be deployed in or around that period in light of the content of the Draft Decision); and
- the nominated market averaging period remain commercial in confidence until the market averaging period has expired.

Should you have any queries in relation to this request, please do not hesitate to contact Jon Windle on [networkregulation@aurizon.com.au](mailto:networkregulation@aurizon.com.au).

Yours sincerely



Michael Riches  
Group Executive Network

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<sup>3</sup> The QCA's stakeholder notice of 15 December 2017 indicated the statutory timeframe for making a decision was 20 June 2018 at that date. Aurizon Network anticipates this date will be further extended or will not be satisfied by that date.