

12 December 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
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Dear Malcolm,

Aurizon Network's 2014 DAU - Queensland Competition Authority's Draft Decision on Aurizon Network's Maximum Allowable Revenue

BHP Billiton Mitsubishi Alliance (BMA) welcomes the opportunity to make a submission to Queensland Competition's Authority's (QCA) draft decision on Aurizon Network's 2014 (hereafter "UT4") proposed Maximum Allowable Revenue (MAR). BMA supports QCA's draft decision to not approve Aurizon Network's proposed MAR as the allowable revenue put forward by Aurizon Network is in excess of that required to efficiently operate the central Queensland coal network (CQCN).

BMA has worked collaboratively with the Queensland Resources Council (QRC), as part of the QRC's 2014 DAU steering committee and working group and supports the QRC submission in response to QCA's draft decision on MAR.

1. Maintenance costs

BMA welcomes QCA's decision to reduce Aurizon Network's proposed maintenance cost allowance on the basis that the proposed costs are significantly higher than that required to efficiently maintain the coal network. BMA also endorses QRC's submission and maintains that the QCA's approach to the assessment of Aurizon Network's maintenance cost allowance should be based on the concept of efficient costs rather than 'reasonable' costs. One of the other concerns that BMA has with respect to maintenance costs is the potential non-delivery of the actual scope of maintenance costs against the forecast scope.

There has been a consistent rise in maintenance cost allowance over the years with the increase being disproportionate to total task or volumes railed. However, the forecast scope and quantum of maintenance has been on the rise. This has been an ongoing cause of concern for the industry regarding actual delivery of maintenance activities against the planned. BMA believes that by cutting annual maintenance allowance in itself will not drive efficiency in Aurizon Network's maintenance program. Any change in the maintenance budget should be measured/ monitored against expected performance metrics specific to each of the maintenance activities. The reporting of metrics should quantify how efficiently and productively Aurizon is using the approved maintenance allowance. Any variance in actual versus budgeted values should be explained with a view to developing more accurate forecasts going forward.

Accordingly, BMA recommends that going forward QCA should develop a quarterly/annual approval and assessment process.

2. Operating costs

BMA supports QCA's decision to reduce the proposed operating costs allowance for Aurizon Network as Aurizon Network had sought an increment of 17% in operating costs over the UT4 regulatory period. The system wide and regional costs have increased significantly between the 2010 access undertaking and the UT4. Again, the proposed increment sought in operating costs is disproportionate to the activities required to operate an efficient stand-alone business. In assessing Aurizon Network's

operating cost allowance BMA believes that it is important to understand that the operating cost build up over the different undertakings are efficient so that the base year provides an efficient benchmark. Accordingly, the QCA should satisfy itself that ample work was done in terms of the efficiency of operating costs or the cost drivers in the previous undertakings.

Further, while BMA is supportive of QCA's decision to significantly reduce corporate overheads costs and the proposal to build in transparency with achievable and measurable productivity targets, BMA believes that providing for some form of productivity measure as a part of the framework in the long run would ensure that Aurizon Network prices its output as it would do in a competitive market. It is worth noting that industry has and is responding to the market environment by making significant costs reductions and therefore there is no reason that Aurizon Network should not do the same on a continuing basis.

BMA is supportive of QCA's decision requiring Aurizon Network to provide details on self-insurance activities as part of the annual regulatory accounts. For example, information on number of historic incidents, number of claims and the types of claims made would provide some information on the fact that Aurizon Network is not double dipping between its maintenance expenditure and capital works program.

3. Volume forecasts

BMA believes that accuracy of volume forecasts for UT4 is important given it forms the basis of reference tariffs, maintenance and operating costs allowance while acting as a trigger for take or pay provisions. The QCA must carefully assess the volumes over the UT4 period particularly in relation to pricing principles for Wiggins Island Rail Project (WIRP) as this could have unintended results if the volumes assumptions are inaccurate.

4. Weighted average cost of capital (WACC)

BMA generally supports QCA's decision of reducing Aurizon Networks WACC to 7.17% over the UT4 period. However, BMA does not support the QCA decision to retain the equity beta values to 2010 undertaking levels even though Aurizon Network's exposure to any meaningful non-diversifiable is negligible under its regulatory framework. As highlighted in QRC's (Oct 2013) submission, Aurizon Network's equity beta appears to be favourable then other infrastructure industries that have a higher degree of exposure to market risk (e.g., Telstra and Sycney Desalination Plant). Given the protections available to Aurizon Network under its access agreement and access agreements BMA seeks a further review of equity beta levels.

5. Revenue adjustments

Aurizon Network had previously agreed with the industry that the difference between the interim MAR and the approved MAR for 2014 would be smoothed over the remainder to the undertaking. This was also approved by the QCA its draft decision on MAR. This information was taken into account by individual coal producers for budgeting purposes. Any drastic change to this proposal would add additional regulatory uncertainty.

Finally, BMA appreciates all the work done by the QCA in the timely release of MAR draft decision.

If you have any queries or require further information, please feel free to contact Ruchi Gupta on [REDACTED]

Yours sincerely,

[REDACTED]
Geoff Streeton

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BHP Billiton Mitsubishi Alliance