

Thursday, 24 November 2016

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Dear Catherine

Pacific National Submission to the QCA on the Aurizon Network Draft Costing Manual October 2016

Introduction

Pacific National welcomes the opportunity to provide comment on the draft Aurizon Network Costing Manual (the Costing Manual) which was submitted to the Queensland Competition Authority (QCA) in October 2016. Pacific National is a major access holder and above rail operator on Aurizon Network infrastructure.

Pacific National comment on the Costing Manual Process

The Aurizon Network Costing Manual covering letter states that the Costing Manual will apply from 1 July 2014 and thus will reflect the costing methodologies in UT4. Pacific National does not believe that consistency between the Costing Manual and UT4 will be possible as these two documents have fundamentally different starting positions. The Costing Manual is based on accounting principles allocating actual costs whereas UT4 is based on economic regulatory principles using efficient costs and stand alone costs. In addition both documents have differing approaches in their treatment of capital costs. As an example of these different approaches Section 4.2.6 of the Costing Manual relates to insurance. Under the Costing Manual approach Aurizon Network receives an allocation of Aurizon Group actual insurance costs. However, the Costing Manual also notes that "The insurance allowance included in the reference tariffs has been estimated for Aurizon Network on a standalone basis and not the allocation basis noted above".

Pacific National recognises that the Costing Manual and UT4 will not be consistent but the differences between the two approaches should be reconcilable. Pacific National believes that regulatory relationship between the costing approaches in the Costing Manual and the costing approaches in access undertaking should be clarified by the QCA.

The timing of the regulatory process relating to the Costing Manual is of some concern to Pacific National as if the Costing Manual had been prepared earlier then the Costing Manual may have informed the UT4 costing process, including informing the level of efficient costs.

Pacific National understand that following the QCA approval of the Costing Manual Aurizon Network will produce and release financial statements for financial years 2014, 2015 and 2016. Pacific National is seeking that these financial statements be released by Aurizon Network within a time frame which allows them to inform the UT5 regulatory process. In particular, the extent to which actual costs are higher or lower than efficient costs will identify areas where Aurizon Network could either improve or areas where efficient costs may have been overestimated.

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Pacific National Comment on the Detail of the Costing Manual

Pacific National has several concerns with the detail of the Costing Manual which are outlined below.

- The Costing Manual section 1.3 outlines the various purposes of the Costing Manual. Pacific National believes that this section should include that an explicit purpose of the Costing Manual is as a means of informing audit and review process to be undertaken by the QCA, (including informing the QCA in relation to potential cost shifting or cross subsidisation between unregulated Aurizon Group operations and regulated Aurizon Network activities). This purpose may be implicit in the Costing Manual but Pacific National believes that it should be explicitly stated in section 1.3.
- The Costing Manual section 2.1 d) states that if QCA ceases to be the regulator then Aurizon Network may withdraw the Costing Manual. Pacific National believes that such an approach is not warranted if another regulatory body, such as the ACCC, continues in a regulatory role similar to the QCA. In these circumstances Pacific National believes that it would be more appropriate for Aurizon Network to maintain the Costing Manual until the processes required by any new regulator are clear.
- The Costing Manual section 2.2 allows Aurizon Network to submit amendments to the Costing Manual to the QCA. Pacific National believes that the QCA should consult with access holders prior to approving or not approving any non-trivial amendments being sought by Aurizon Network.
- Pacific National generally supports the costing principles in section 3.2 of the Costing Manual but believes these principles could be further improved by explicitly including a principle that no cost will be fully allocated more than once (i.e. there will be no double-counting of costs). This principle may be implicit in the Costing Manual but Pacific National believes that it should be explicitly stated in section 3.2.
- The Costing Manual section 3.2 d) states that rigid application of the Costing Manual methodology is not required for immaterial amounts. Pacific National does not oppose this concept but seeks that there be some definition of “immaterial amounts”.
- Section 3.2 c) of the Costing Manual refers to allocating joint costs and common costs on a reasonable basis, with the basis for these allocations being expanded upon in Part 4 of the Costing Manual (particularly section 4.2.10 Corporate Costs). Pacific National has had ongoing concerns regarding Aurizon Network’s allocations of corporate costs as cost allocation decisions within the vertically integrated Aurizon Group have substantial impacts on the pricing and profitability of different parts of Aurizon, including Aurizon’s above rail activities. This in turn impacts on the competitive position of Pacific National as both a customer of Aurizon Network and as a competitor of Aurizon above rail services.

Pacific National’s concern with these allocations is that they are at a relatively high-level, and that more detail should be provided. In particular if allocation approaches or allocators used differ between the Costing Manual and UT4 this should be noted. This will allow comparison between allocations of actual costs as per the Costing Manual and the allocation of costs assumed in UT4.

- The cost allocation methodologies as contained in sections Part 4 of the Costing Manual do not appear to allocate costs to the level of the individual rail systems. Pacific National believes that an allocation of costs to the individual rail systems would be beneficial, particularly given that reference tariffs are determined for each individual rail system rather than for Aurizon Network as a whole. Allocation of costs

to this level would provide greater transparency and allow comparisons between allocated costs and the costs which underpin reference tariffs.

- Table 4.3 includes a heading “Other Below Rail Services”. Pacific National believes that this heading should read “Other Services”. This would align the wording in the table with the subsequent explanatory paragraph.
- Schedule 1 of the Costing Manual outlines the pro forma financial statements which are the outcome of applying the Costing Manual. Pacific National’s concern with these statements is that they are relatively high-level financial statements and as such are of limited use to third parties such as access holders. As outlined earlier in this submission these financial statements should be further disaggregated to the rail system level and expense elements should be provided at a similar level of detail to that provided in the UT4 regulatory process. This will allow comparison between allocations of actual costs and the costs assumed in UT4 (recognizing that the UT4 costs may have been determined on a different basis).
- Schedule C of the Costing Manual outlines the Aurizon Group structure, which includes Aurizon Group corporate functions such as finance and legal. Pacific National understands that Aurizon Network has business units such as legal and finance which duplicate these corporate functions. Given this, Pacific National believes that any allocation of Aurizon Group corporate costs to Aurizon Network for functions which are duplicated within Aurizon Network should be minimal. In addition Pacific National has concerns that, notwithstanding section 3.1 d) of the Costing Manual, the Aurizon Group and Aurizon Network organisational structures will change over time impacting the cost allocations in the Costing Manual. Pacific National is seeking that Aurizon Network submit Costing Manual amendments to the QCA following any substantial organisational change or otherwise confirm that the substantial organisational change does not impact on the Costing Manual.

Conclusion

Pacific National recognises that the draft Costing Manual is an improvement on the current Costing Manual; however further improvements could be made to the Costing Manual. In particular further information could be provided on the allocation of joint and common costs (particularly corporate costs) and information provided should be disaggregated to at least the level of individual rail systems.

If you wish to discuss this submission please contact me on 02 8484 8056 or Ying Yeung on 07 3002 3726.

Yours sincerely



Stuart Ronan
Manager Access and Regulation

