

## STAKEHOLDER NOTICE

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24 October 2019

### Queensland Rail's 2020 Draft Access Undertaking

#### West Moreton coal pricing approach—discussion paper

The Queensland Competition Authority (QCA) is seeking further comment from stakeholders on the appropriate pricing approach for West Moreton coal services, given the continued uncertainty about future volumes. Submissions are due by **28 November 2019**.

This paper outlines our preliminary consideration of an approach that may be appropriate to pricing at low volumes, and includes several discussion topics to assist stakeholders in preparing their comments.

This paper is intended to give stakeholders an insight into that approach to encourage further contributions. Our consideration of the approach and the statutory assessment criteria is not finalised and our thinking may change in making the final decision. Our final decision will be informed by submissions made in response to this paper. This paper is not a draft version of a final decision, and it has no force of itself. There should be no expectation that it presents approaches and recommendations that will prevail to the end of the decision making process.

#### Background

Queensland Rail submitted its 2020 draft access undertaking (2020 DAU) in August 2018, and we published our draft decision in April 2019. Stakeholders provided initial submissions on the draft decision in July 2019 and collaborative submissions on 27 September 2019.

We maintain our objective of having an appropriate undertaking ready to replace the 2016 access undertaking when it terminates in June 2020.

However, the future of the New Acland mine, which has accounted for about two-thirds of West Moreton coal volumes, is subject to an ongoing approval process. This means that key inputs, including the volumes and associated costs for West Moreton over the regulatory period, are unlikely to be settled in time for our intended February 2020 decision.<sup>1</sup>

Queensland Rail said in its collaborative submission that it would submit proposed costs and a proposed price in mid-November 2019, for annual coal volumes of 2.1 million tonnes—that is, without any forecast New Acland services.<sup>2</sup>

Our draft decision derived a reference tariff, based on the building blocks, which reflected the high-volume scenario of 9.1 million tonnes a year that Queensland Rail submitted in its DAU. However, we said that, if warranted, we might consult further on an appropriate pricing approach for a low-volume scenario before finalising our positions.<sup>3</sup>

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<sup>1</sup> The approval process in the QCA Act includes time for Queensland Rail to respond to our decision, which therefore has to be about four months before the intended date for the new undertaking to take effect.

<sup>2</sup> Queensland Rail, sub. 36: 10.

<sup>3</sup> QCA, April 2019: 8.

## Pricing at low volumes

We consider that there is merit in having a reference tariff for West Moreton coal services at low volumes, assessed using the building blocks, to promote consistency, transparency and timeliness. However, the loss of two-thirds of volumes on West Moreton, even if only transitory, is a significant factor that must be accounted for and may require some material changes to the pricing approach, possibly including making the reference tariff the ceiling price for negotiating an access charge.

While the 2020 DAU and our draft decision provided some preliminary analysis of costs at 2.1 million tonnes, we are now assessing those costs in more detail. This will include having regard to the further submission Queensland Rail has said it will provide in mid-November. However, based on the information we already have, we are keen to explore stakeholders' views on the need for:

- price flexibility, including an ability for parties to negotiate access charges away from the reference tariff
- an endorsed variation event, to adjust the reference tariff if there is a significant increase in contracted volumes on West Moreton
- an approach to account for capitalised losses.

These considerations are addressed in turn below.

### Price flexibility

We consider it may be appropriate to provide flexibility for Queensland Rail and its customers to negotiate access charges that are lower than the reference tariff, and for the QCA to be able to determine disputes about access charges without being bound to that reference tariff (ceiling price).

Queensland Rail has estimated that the building blocks price for West Moreton at annual volumes of 2.1 million tonnes would be about three times that approved for the 2016 access undertaking.<sup>4</sup> This would most likely be beyond the willingness to pay of any affected access holder or seeker. Queensland Rail has said it would not seek to charge such a high price, and the West Moreton users have argued that access charges at those levels would be economically unviable, and likely to be beyond their willingness to pay.<sup>5</sup>

The standard access agreement (SAA) provides for access charges to be varied if there is a change in the reference tariff under Queensland Rail's access undertaking.<sup>6</sup> If the parties are unable to agree on how the access charges should be varied, then they can turn to the dispute resolution process.<sup>7</sup> However, the 2020 DAU (like the 2016 undertaking) requires that the access charge for the reference train service be consistent with the reference tariff.<sup>8</sup>

We are concerned that the overall effect of the SAA and 2020 DAU provisions could be that the reference tariff in the undertaking 'locks in' the access charge, rather than simply being a guide or ceiling for negotiations. In particular, the QCA Act requires that, in an arbitration, the QCA 'must not make an access determination that is inconsistent with the approved access undertaking' for the service (s. 119(1)(a) of the *Queensland Competition*

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<sup>4</sup> Queensland Rail, sub. 2: 42.

<sup>5</sup> Queensland Rail, sub. 2: 11; New Hope sub. 14: 15, sub. 33: 14–16; Yancoal, sub. 16: 3; sub. 27: 12.

<sup>6</sup> See cl. 18.1 of the SAA for the 2016 access undertaking, which Queensland Rail has proposed to carry through unchanged in the 2020 DAU. In reviewing a change in the access charge, Queensland Rail must have regard to the reference tariff, any differences from the reference train service, and 'any other relevant provision of the access undertaking'.

<sup>7</sup> See cl. 19 of the 2016 undertaking SAA.

<sup>8</sup> See cls. 3.0(b) and 3.3(c) of the 2020 DAU.

*Authority Act 1997 (QCA Act)*<sup>9</sup>). We are also mindful of the possible effects the 2020 DAU provisions might have on existing access holders.

A 'locked-in' access charge might require Queensland Rail to seek to charge more than its customers were willing to pay, which might be against the interests of access seekers and access holders (ss. 138(2)(e), (h)). And, to the extent that hampered Queensland Rail's ability to retain existing customers and find new customers for unused capacity, it might be against Queensland Rail's interests as well (s. 138(2)(b)). Discouraging coal customers from using the service might also make it more difficult for Queensland Rail to recover the efficient costs of providing access (ss. 138(2)(g), 168A(a)).

We therefore consider it may be appropriate to amend the 2020 DAU to:

- (a) make it clear that the access charge for the reference train service need not be consistent with the reference tariff (i.e. that it may be lower)
- (b) provide that the QCA, in arbitrating an access dispute, need not necessarily apply the reference tariff as the access charge for the reference train service
- (c) make consequential changes, including to the take or pay and relinquishment fee provisions, and to the SAA, which would be necessary to give effect to flexibility for the parties to negotiate access charges.

This may promote efficient use of the West Moreton system, where the access charges encourage customers to use the network, while maximising the revenue that Queensland Rail can recoup, below the standalone cost of providing access (ss. 138(2)(a), (g), 168A(a)). For similar reasons, it may be in the interests of Queensland Rail, including its interest in maximising recovery of its sunk costs (ss. 138(2)(b), (g), 168A(a)). Allowing for access charges to be lower than the reference tariff may also be in the interests of access seekers and access holders and may promote the efficient use of rail infrastructure and competition in dependent markets, particularly at low volumes (ss. 138(2)(a), (d), (e), (h)).

#### Summary 1

Our preliminary consideration is that it may be appropriate for Queensland Rail to amend the 2020 DAU to:

- (a) specify that the access charge for the reference train service need not be consistent with the reference tariff
- (b) specify that the QCA, in arbitrating an access dispute, will not necessarily apply the reference tariff to the reference train service
- (c) make consequential amendments, including to the take-or-pay and relinquishment fee provisions, and to the SAA, which would be necessary to make an access charge that is not calculated by reference to the reference tariff operate effectively.

#### **Endorsed variation event—increased contract volumes**

Our preliminary pricing approach has been constructed having regard to current information available about forecast volumes (2.1 million tonnes a year). However, volumes could increase, potentially significantly, during the term of the undertaking. Queensland Rail has submitted that it still expects low West Moreton coal volumes in the early years of the 2020 DAU period to be 'transitory'.<sup>10</sup>

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<sup>9</sup> Unless otherwise stated, references to statutory sections are to the QCA Act.

<sup>10</sup> Queensland Rail, sub. 36: 10.

Mechanisms to vary reference tariffs in response to increasing volumes are one way to address material changes in circumstances.

While the 2020 DAU requires Queensland Rail to submit endorsed variation events to vary the reference tariffs in certain circumstances, this does not include resetting tariffs if contracted volumes are greater than the forecasts used to develop the tariffs. Our draft decision suggested such a mechanism might be appropriate if the volume forecasts used were substantially less than the capacity that was available for coal services to contract.<sup>11</sup> West Moreton users have said that endorsed variation events for increases in contracted coal services should be available.<sup>12</sup>

We consider that it may be appropriate to provide a process for recalculating the reference tariffs to reflect additional contracting. This mechanism will reduce the reference tariff, having regard to efficient costs. Any resulting adjustment would need to take into account capitalised losses (discussed below).

We accept that in the near term, with very low volumes, any impact of the price reset mechanism is likely to be small (and will in any event be indirect) to the extent that the access charge being paid is less than the reference tariff. However if, as stakeholders suggest, volumes return to levels more akin to the 'high-volume' scenario, the potential benefits from contracting additional volumes (to realise lower prices) may increase. At those volumes, the reference tariff is likely to decline to a level that is within the range access holders and seekers are willing to pay. In this way, providing for an endorsed variation event for increased contract volumes may promote the economically efficient use of, operation of, and investment in the network (s. 138(2)(a)) and may be in the interests of access seekers and access holders (ss. 138(2)(e), (h)). It may also be in the interests of Queensland Rail, to the extent it promotes revenue adequacy (ss. 138(2)(b), (g), 168A(a)).

## Summary 2

Our preliminary consideration is that it may be appropriate for Queensland Rail to amend the 2020 DAU to require an endorsed variation event when contract volumes are greater than the volume forecasts used to assess the reference tariff.

### Loss capitalisation

We consider that it may be appropriate to account for the difference, if any, between the revenues that we have assessed as appropriate for Queensland Rail to recover efficient costs, and the actual revenue recovered by Queensland Rail through access charges.

Queensland Rail has proposed that it will apply a 'loss capitalisation' approach to the difference between approved and actual revenue, if volumes fall to a low level during the 2020 undertaking period. It has indicated that it will provide further details of how this will work in its supplementary submission in mid-November.<sup>13</sup> Stakeholders have indicated that they are open, in principle, to some degree of loss capitalisation, in particular where the approach has a 'limited life'.<sup>14</sup>

While it is not clear whether, when or from whom any capitalised losses might be recouped under Queensland Rail's proposal, we consider it may be appropriate, in principle, to account for any accumulated shortfall in Queensland Rail's recovery of efficient costs. This may be in the interests of Queensland Rail, by providing a potential way for it to recoup efficient costs, but which it has not been able to recover through access charges (s. 138(2)(b)). For similar

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<sup>11</sup> QCA, April 2019: 17.

<sup>12</sup> New Hope, sub. 24: 9–10, sub. 33: 17; Yancoal, sub. 27: 5, sub. 41: 10.

<sup>13</sup> Queensland Rail, sub. 36: 10.

<sup>14</sup> New Hope, sub. 24: 15, 33; sub. 5: 16; Yancoal, sub. 27: 13, sub. 41: 6.

reasons, it may promote efficient investment in and operation of the network, and the pricing principles (ss. 138(2)(a), (g), 168A(a)).

However, loss capitalisation will shift costs and risks between users, depending on the mix of users (current or future) and their access rights. An effective mechanism, which suits the nature of the asset and the market for access, may be required to properly account for the interests of access seekers and access holders (ss. 138(2)(e), (h)).

Our draft decision highlighted that an appropriate loss capitalisation approach would:

- (a) be symmetrical—in that any over-recovery should also be placed in this account and accrue at the WACC to offset any subsequent under-recovery
- (b) have a limited life—to prevent the accumulated amount in the under-recovery account from ballooning to a level at which there is no reasonable prospect of recovery.<sup>15</sup>

### Summary 3

Our preliminary consideration is that it may be appropriate, in principle, for Queensland Rail to amend the 2020 DAU so that unrecouped costs of providing access on the West Moreton system are recorded in a loss capitalisation account, to enable recovery at a later time if demand increases.

### Role of reference tariffs at low utilisation

Where there is a single customer, the cost and effort required to establish a reference tariff may not be warranted. This will be particularly true where the majority of available capacity is forecast to be unused. For most of Queensland Rail's network, including the Mount Isa line, access charges have been negotiated between Queensland Rail and access seekers, without a reference tariff. Access seekers have had recourse to dispute resolution during those negotiations. So the QCA, having regard to s. 138(2) of the QCA Act, and to the views of Queensland Rail and other stakeholders, may find a West Moreton reference tariff is not appropriate for the next undertaking period (i.e. starting in July 2025).

However, we consider that it may be appropriate to continue with a reference tariff for West Moreton coal (which acts as a ceiling price in negotiations) for the 2020 undertaking period, for a number of reasons, including that:

- (a) there is still a real possibility that volumes will rise sufficiently that a reference tariff falls to a level that is likely to be within the range of customers' willingness to pay. In particular, New Hope has continued to pursue the approvals required to extend the life of New Acland, and Queensland Rail has said it expects demand to recover
- (b) the information published during the process of assessing the reference tariff will also provide access seekers with transparency about likely access charges at higher volumes, and much of the work, and therefore cost, of compiling this has already been completed
- (c) having a reference tariff will enable the endorsed variation event mechanism to work should contracted volumes rise, which will provide greater certainty about likely access charges for parties considering contracting for unused capacity
- (d) moving to arrangements with no reference tariff at this time may be too abrupt, and may not give Queensland Rail, access holders or access seekers sufficient time to prepare for negotiating without a reference tariff.

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<sup>15</sup> QCA, April 2019: 64.

Accordingly, our preliminary consideration is that the approach set out above, with a reference tariff determined, but with flexibility to move away from it, may be appropriate at this time. Further, the pricing approach, combined with loss capitalisation, may maximise the opportunity for Queensland Rail to recover the efficient costs of providing access, which may promote efficient operation of and investment in rail infrastructure (s. 138(2)(a), (b), (g), 168A(a)). It may also be in the interest of access holders and access seekers, by enabling pricing that is flexible when circumstances change and providing transparency about likely prices at high volumes (ss. 138(2)(e), (h)), and it may promote the efficient use of rail infrastructure and competition in dependent markets (ss. 138(2)(a), (d)).

## Topics for comment

We have developed the below list of questions to assist stakeholders in preparing further submissions on the West Moreton pricing approach in the 2020 DAU. Given stakeholders have had extensive opportunities to comment on other matters, including through initial and collaborative submissions on our draft decision, we are not inviting submissions at this time on aspects of the 2020 DAU other than the West Moreton pricing approach.

While these questions highlight some relevant matters, they do not seek to comprehensively cover all the topics raised to date, or the matters discussed above. Hence, interested parties should rely on their own analysis to determine whether there are additional matters related to the West Moreton pricing approach on which they wish to comment.

- (1) Does a 'de-coupling' of access charges from the reference tariff provide an appropriate way forward given the forecasts of low volumes and substantial unused capacity?
- (2) Is it appropriate to also 'de-couple' take or pay and relinquishment fees from the terms set out in the access undertaking?
- (3) Would 'de-coupling' access charges from the reference tariff work with existing access agreements?
- (4) Is it appropriate to include an endorsed variation event for resetting the reference tariff when contract volumes increase, if access charges are 'de-coupled' from the reference tariff?
- (5) If an endorsed variation event for increases in contracted volumes is included, should it be subject to a materiality threshold?
- (6) What features of a loss capitalisation approach are required so that it suits the nature of the West Moreton asset and the market for access?
- (7) If access charges are 'de-coupled' from the reference tariff, does our draft decision approach to estimating WACC appropriately compensate Queensland Rail?

Queensland Rail said it intended to provide further information on West Moreton costs and a proposed pricing approach at low volumes in mid-November. Stakeholders may wish to comment on that new information if it becomes available during this period for submissions.

In assessing the 2020 DAU, we will consider whether it is appropriate to approve having regard to the criteria in section 138(2) of the QCA Act. Stakeholders may wish to address these criteria in their comments on the matters discussed above, and on Queensland Rail's 2020 DAU and subsequent submissions. We will also have regard to submissions made on Queensland Rail's volume and reference train service review event and draft amending access undertaking (DAAU) under the 2016 undertaking, in so far as they are relevant.<sup>16</sup> Stakeholders are encouraged to have regard to those submissions.

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<sup>16</sup> These are available on our website at <https://www.qca.org.au/project/queensland-rail/2016-access-undertaking/reference-tariff-adjustments/>

## Way forward

We consider that publishing a final decision in February, with the objective of having a new undertaking in place on 1 July 2020, remains feasible and desirable. We accept that key inputs for the West Moreton reference tariff remain uncertain, however the approach outlined above seeks to deal with this appropriately, without delaying the approval of the new access undertaking.

The consequence may be that there will be a subsequent adjustment to the West Moreton pricing approach during the term of the 2020 undertaking, if contracted volumes increase. This might be effected through an endorsed variation event, or Queensland Rail might choose to submit a review event application or voluntary DAAU.<sup>17</sup>

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<sup>17</sup> Review events and voluntary DAAUs are at Queensland Rail's discretion.

## Submissions

**Closing date for submissions: 28 November 2019**

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore further submissions are invited from interested parties concerning the QCA's assessment of the proposed West Moreton tariff in Queensland Rail's 2020 DAU. The QCA will take account of all submissions received within the stated timeframes

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority  
GPO Box 2257  
Brisbane Q 4001

Tel (07) 3222 0555  
Fax (07) 3222 0599

[www.qca.org.au/submissions](http://www.qca.org.au/submissions)

### Confidentiality

In the interests of transparency and to promote informed discussion and consultation, the QCA intends to make all submissions publicly available. However, if a person making a submission believes that information in the submission is confidential, that person should claim confidentiality in respect of the document (or the relevant part of the document) at the time the submission is given to the QCA and state the basis for the confidentiality claim.

The assessment of confidentiality claims will be made by the QCA in accordance with the *Queensland Competition Authority Act 1997*, including an assessment of whether disclosure of the information would damage the person's commercial activities and considerations of the public interest.

Claims for confidentiality should be clearly noted on the front page of the submission. The relevant sections of the submission should also be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two versions of the submission (i.e. a complete version and another excising confidential information) could be provided.

A confidentiality claim template is available on request. We encourage stakeholders to use this template when making confidentiality claims. The confidentiality claim template provides guidance on the type of information that would assist our assessment of claims for confidentiality.

### Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at our Brisbane office, or on our website at [www.qca.org.au](http://www.qca.org.au). If you experience any difficulty gaining access to documents, please contact us on (07) 3222 0555.

## List of submissions

We have received the following submissions during our investigation of Queensland Rail's 2020 DAU to date. The submission numbers below are used in this discussion paper for referencing purposes. The submissions are available on our website unless otherwise indicated.

Stakeholder	Submission	Number	Date
Aurizon Bulk	Submission on Queensland Rail's 2020 DAU	11	17 Oct 2018
	Queensland Rail's 2020 Draft Access Undertaking (DAU2) [draft decision response]	22	11 July 2019
Aurizon Coal	Submission on Queensland Rail's 2020 DAU	12	17 Oct 2018
	Queensland Rail's 2020 Draft Access Undertaking (DAU2) Draft Decision Response	23	11 July 2019
	Queensland Rail's Draft Access Undertaking 2 [collaborative submission]	28	27 Sept 2019
Glencore (Mount Isa Mines)	Queensland Rail 2020 Draft Access Undertaking [collaborative submission]	29	27 Sept 2019
	Att 1: Collaborative Undertaking and SAA Drafting	30	27 Sept 2019
	Att 2: Regional Network User Group Drafting	31	27 Sept 2019
Incitec Pivot	Queensland Rail's 2020 Draft Access Undertaking [collaborative submission]	32	27 Sept 2019
New Hope	Cover letter	13	17 Oct 2018
	Submission on Queensland Rail's 2020 DAU, Volume 1: Overview and Reference Tariffs	14	17 Oct 2018
	Submission on Queensland Rail's 2020 DAU, Volume 2: Undertaking and Standard Access Agreement	15	17 Oct 2018
	Submission in response to Queensland Competition Authority Draft Decision: QR 2020 Draft Access Undertaking	24	11 July 2019
	Submission in response to Queensland Competition Authority Draft Decision: QR 2020 Draft Access Undertaking [collaborative submission]	33	27 Sept 2019
Pacific National	Submission on Queensland Rail's 2020 DAU	17	7 Nov 2018
	Draft Decision—Queensland Rail's 2020 Draft Access Undertaking	25	11 July 2019
	Further Submission—Queensland Rail's 2020 Draft Access Undertaking	34	27 Sept 2019
Queensland Rail	2020 Draft Access Undertaking	1	14 Aug 2018
	Explanatory document	2	14 Aug 2018
	Att 1: West Moreton Tonnage Forecasts (not published)	3	14 Aug 2018
	Att 2: Independent Expert Report on Asset Beta and Equity Beta, report by Frontier Economics	4	14 Aug 2018

Stakeholder	Submission	Number	Date
	Att 3: West Moreton system DAU2 capital expenditure submission	5	14 Aug 2018
	Att 4: Peer Review of West Moreton System DAU2 Capital Expenditure 2020-21 to 2024-25, report by GHD	6	14 Aug 2018
	Att 5: West Moreton system DAU2 maintenance costs 2020–21 to 2024–25	7	14 Aug 2018
	Att 6: Peer Review of West Moreton System DAU2 Maintenance Costs 2020-21 to 2024-25, report by GHD	8	14 Aug 2018
	Att 7: Independent Expert Report on Price Differentiation, report by HoustonKemp	9	14 Aug 2018
	Att 8: Independent Expert Report on Contract Renewal Rights, report by HoustonKemp	10	14 Aug 2018
	Queensland Rail's Response to Industry Comments on Queensland Rail's Draft Access Undertaking 2 (DAU2)	18	16 Nov 2018
	Att 1: Response to submissions on low volume scenarios, report by Frontier Economics	19	14 Nov 2018
	Att2: Response to submissions on the required return for Queensland Rail, report by Frontier Economics	20	26 Oct 2018
	Queensland Rail's Response to the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (DAU2)	26	11 July 2019
	Queensland Rail's Draft Access Undertaking 2 (DAU2), cover letter [collaborative submissions]	35	27 Sept 2019
	Response to industry comments on the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (Collaborative Submissions)	36	27 Sept 2019
	Att 1: Drafting changes	37	27 Sept 2019
	Att 2: DAU2 cost allocation for the West Moreton System, report by HoustonKemp	38	27 Sept 2019
	Att 3: Approaches to the WACC for rail networks, report by HoustonKemp	39	27 Sept 2019
	Att 4: Evaluation of inflation forecasting methods, report by HoustonKemp	40	27 Sept 2019
Yancoal	Submission on Queensland Rail's 2020 DAU	16	17 Oct 2018
	Response to the QCA's request for collaborative submissions on Queensland Rail's 2020 DAU	21	16 Nov 2018
	QR 2020 Draft Access Undertaking Submission in Response to QCA Draft Decision	27	11 July 2019
	QR 2020 Draft Access Undertaking Submission in Response to QCA Draft Decision [collaborative submission]	41	27 Sept 2019