

Aurizon Network Access Undertaking (2010)

FY2015 Revenue Adjustment Amounts Explanatory Memorandum

21 December 2015



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1 Executive Summary

1.1 Introduction

At the QCA's request, Aurizon Network is resubmitting its FY2015 Revenue Cap submission to the Queensland Competition Authority (QCA) for approval.

This submission details the Revenue Adjustment Amounts for Financial Year (FY) 2015, as required by Schedule F, Part B of Aurizon Network's 2010 Access Undertaking (2010AU)¹.

Under the 2010AU, Aurizon Network:

- is required to recover from (or return to) access holders, Revenue Adjustment Amounts, comprising the difference between revenues earned (Total Actual Revenues (TAR)) and revenues allowed (System Allowable Revenues (SAR)) for the relevant Reference Tariff components; and
- may make a claim to retain a portion of the over-recovery (an Increment) to the extent it can demonstrate that the over-recovery resulted in whole or part as a direct result of whole of coal chain activities or initiatives of Aurizon Network (or its contractors) which have increased the efficiency of the Below Rail network. This portion must be no greater than 2% of the relevant SARs.

Aurizon Network originally provided its FY2015 Revenue Cap and Increment submission to the QCA on 30 September 2015 (Original Submission). Aurizon Network sought an extension of time for completion of the Increment claim component of the submission, on the basis that it was seeking further guidance from the QCA as to what evidence might be required to support an approved Increment claim. In the event, the QCA declined an extension to the Increment claim component, as its view was that it must consider the Revenue Cap Adjustments and Increment claim together. It did however offer Aurizon Network an extension of time to resubmit its FY2015 Revenue Cap submission (with or without an Increment claim) until 21 December 2015.

For the reasons outlined in section 1.3 below, Aurizon Network has decided not to submit an Increment Claim for FY2015. As a result, those portions of the Original Submission relating to the Increment Claim have been removed. Otherwise, there have been no changes from the Original Submission, apart from small changes to this Executive Summary section to explain the reasons for the resubmission and exclusion of the Increment claim, minor clarifications to the text (which do not affect any of the Revenue Adjustment Amounts), a short discussion of removal of the Increment claim (section 1.3) and inclusion of a short final section (section 6) setting out Aurizon Network's response to issues raised by stakeholders' submissions to the QCA in respect of the Original Submission.

There have been no changes to the Revenue Adjustment Amounts or to the financial models included with the Original Submission.

1.2 Revenue Adjustment Amounts

¹ Clause 3.2 in respect of the Revenue Adjustment Amounts and Clause 3.3 in respect of the Increments

The Revenue Adjustment Amounts include the:

- AT₂₋₄ Reference Tariff components for Blackwater, Goonyella, Moura, Newlands and Goonyella to Abbot Point (GAPE) systems; and
- AT₅ and EC Reference Tariff components for the Blackwater and Goonyella systems.

This submission details the:

- returns to Access Holders for the Blackwater, Goonyella and Newlands systems; and
- recovery from Access Holders for the Moura system.

Aurizon Network is not seeking a recovery from, or return to Access Holders for the GAPE system for FY2015 as a result of Take-or-Pay triggering in this system.

This submission does not seek adjustments for the Maintenance Cost Index (MCI), the Consumer Price Index (CPI) or electricity connection costs, as these are being considered as part of the QCA's assessment of the 2014DAU.

The Revenue Adjustment Amounts are summarised in Table 1 below², with further detail provided in Section 3, 4 and 5 and within Attachment A.

| System | AT ₂₋₄ \$m | AT ₅ \$m | Total \$m |
|--------------|--------------------------|------------------------|---------------|
| Blackwater | (8.3) | 4.7 | (3.7) |
| Goonyella | (19.1) | (7.0) | (26.1) |
| Moura | 2.8 | n/a | 2.8 |
| Newlands | (0.6) | n/a | (0.6) |
| GAPE | - | n/a | - |
| Total | (25.3) | (2.3) | (27.6) |

Table 1 FY2015 Revenue Adjustment Amounts

Consistent with the process outlined in the 2015 Amending Access Undertaking (2015 AAU), the difference between actual and revised transitional SARs is intended to be returned to, or recovered from, Access Holders via an adjustment to future allowable revenues. This will form part of the finalisation of the 2014 Draft Access Undertaking (2014DAU). Further details on the application of the 2015 AAU are provided in Section 2.3.

1.3 Removal of Increment Claim

Aurizon Network has decided not to make an Increment claim for FY2015, for the reasons set out below.

In FY2015, over 225 million tonnes were railed across the Central Queensland Coal Region (CQCR), significantly exceeding the QCA-approved transitional system forecasts in the Blackwater and Goonyella systems. This resulted in an over-recovery of SAR in those systems, totaling \$29.8 m, which would have allowed for a total maximum Increment claim of \$9.6m (i.e. 2% of SAR across both the Blackwater and

² Positive amounts represent a recovery from Access Holders, negative amounts represent a return to Access Holders

Goonyella systems). This achievement reflects the sustained effort and aligned planning by all supply chain participants including mines, ports, train operators and Aurizon Network. A material component of the improvement in system performance has resulted from activities and initiatives undertaken by Aurizon Network or in partnership with other supply chain participants.

Aurizon Network's Original Submission dated 30 September 2015, contained details of a number of initiatives and activities that Aurizon Network considers contributed to the above-forecast railings in FY2015 and which it considered could have formed the basis of an Increment claim. However, as its Increment claim in previous years had been unsuccessful, rather than submitting a formal Increment claim with the Original Submission, Aurizon Network's Original Submission requested guidance from the QCA as to what evidence it would need to support a successful Increment claim and sought extension of time to submit a finalised Increment claim for FY2015.

In response, stakeholders submitted to the QCA that it is inappropriate for Aurizon Network to claim an Increment under the terms of the 2010AU, for a year that forms part of the UT4 period.

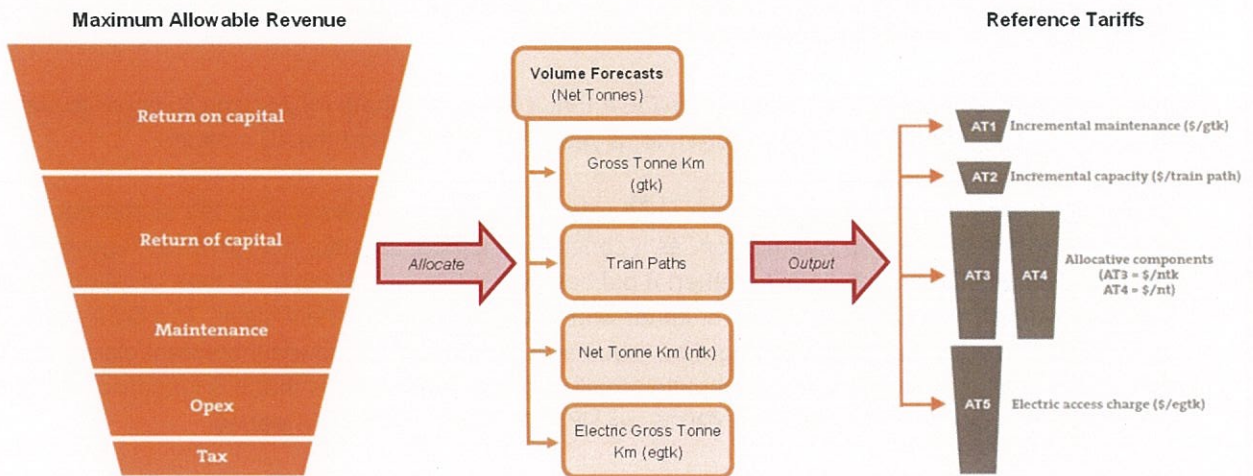
In its letter dated 20 November 2015, the QCA refused to allow an extension for the Increment claim portion of the Revenue Cap Submission, as it considered it must approve the Revenue Adjustment Amount and any Increment claim together. It did however, allow an extension of time to resubmit the Revenue Adjustment Claim for FY2015, either with or without an Increment claim. The QCA did not give any guidance as to what evidence might be required to support an approved Increment claim. The QCA also indicated it was giving due consideration to stakeholder submissions that it is inappropriate to claim an Increment under the 2010AU for FY2015, as FY2015 is part of the UT4 period.

Aurizon Network does not consider that the position advanced by stakeholders with respect to the Increment claim is correct, as it is the 2010AU which governs any Increment claim made in respect of a period to which the 2010AU applies (including FY2015). However, in view of the lack of formal guidance from the QCA as to the evidence that they would require to approve a claim under the 2010AU, Aurizon Network has decided not to submit an Increment claim for FY2015. This decision has been made despite Aurizon Network's view that its activities initiatives have resulted in significant network efficiencies, will continue to do so into the future and its view that it should be offered incentives and rewarded for such initiatives.

2 Summary of Revenue Cap Method

2.1 2010AU Regulated Revenues

Aurizon Network's regulated revenues are derived using a regulatory 'building blocks' approach where capital and operating costs are aggregated into a Maximum Allowable Revenue (MAR) for each system. The approved MAR is then translated into Reference Tariffs based on approved volume forecasts using expected railings. SAR represents the allowable revenue recoverable through the AT₂₋₄ and AT₅ Reference Tariffs, which form the basis of Aurizon Network's Revenue Cap.

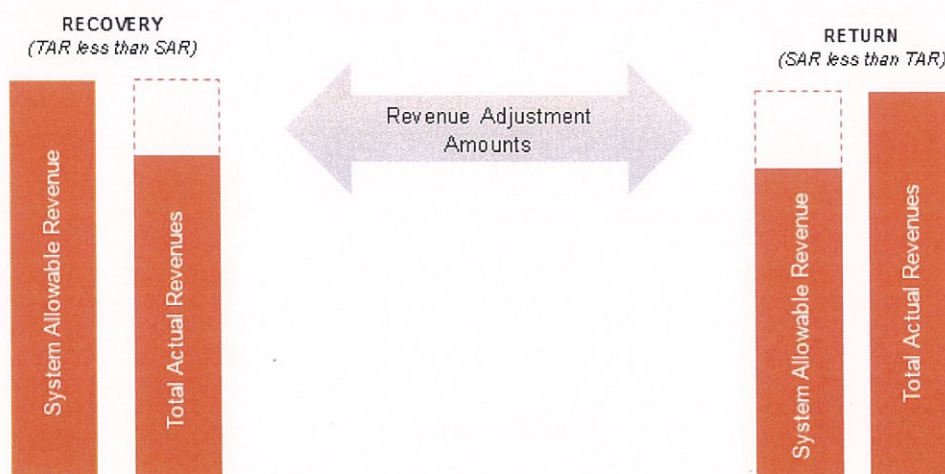


Schedule F of the 2010AU details:

- the basis on which Aurizon Network recovers revenues from Access Holders, i.e. primarily from Reference Tariffs charged for trains operated; and
- the guidelines on Take or Pay, Adjustment Charges and revenue cap to enable Aurizon Network to earn the SAR in each system in the same or subsequent years.

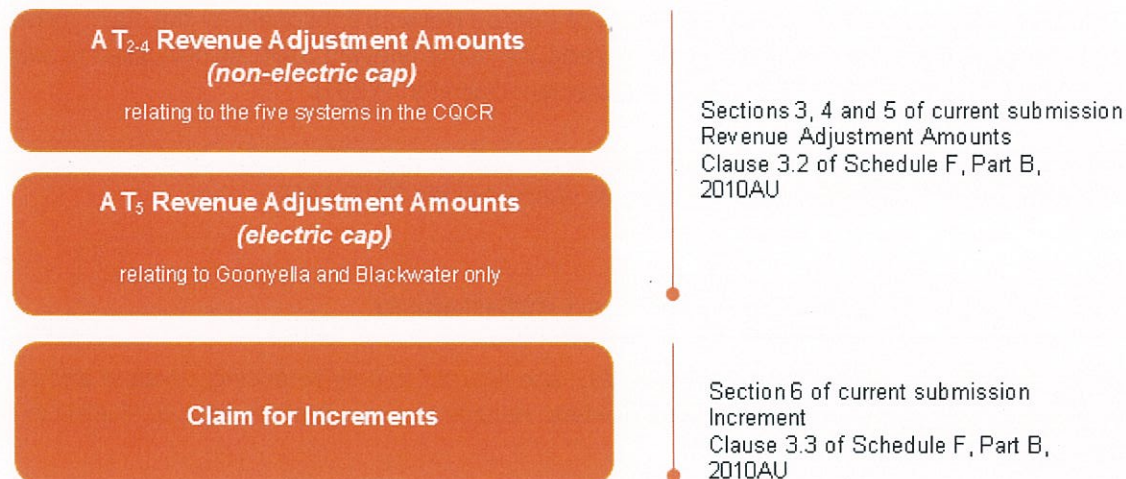
2.2 Revenue Cap Framework

Aurizon Network is required to recover from (or return to) Access Holders the Revenue Adjustment Amounts, being the difference between revenues earned (TAR) and revenues allowed (SAR) for the relevant Reference Tariff components.

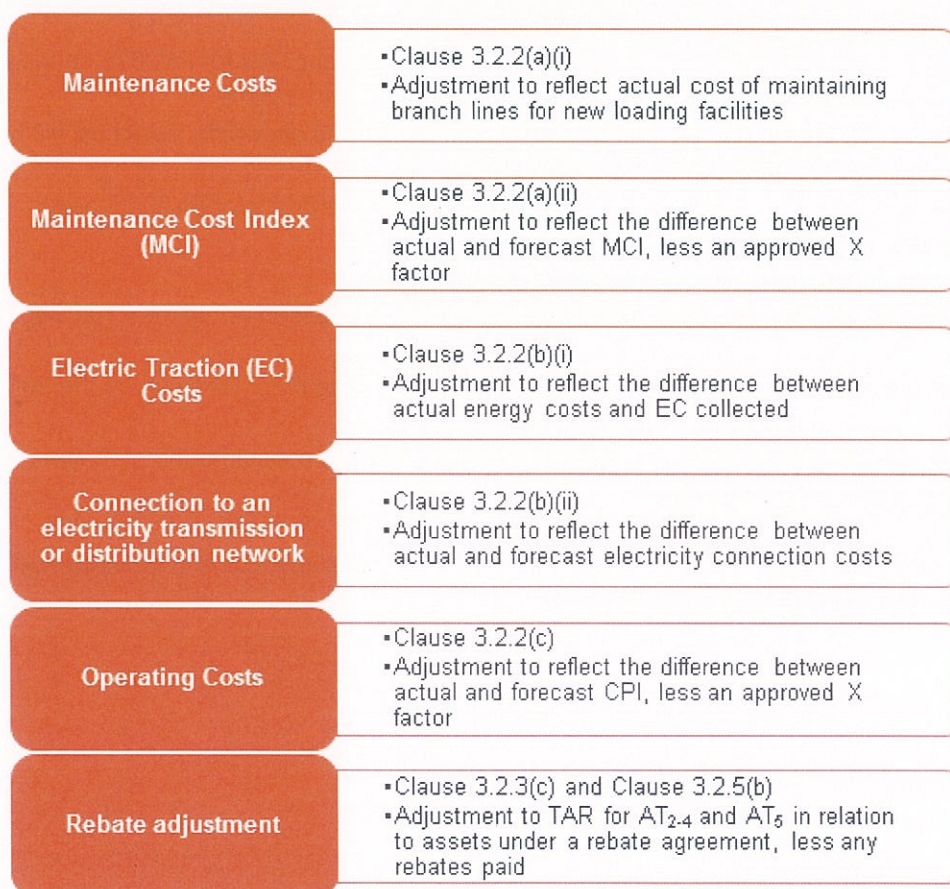


There are seven revenue caps, a 'non-electric' revenue cap (AT₂₋₄) for each of the five systems plus two 'electric' revenue caps (AT₅), one each for Blackwater and Goonyella.

The following must be addressed by Aurizon Network for each system by way of a submission to the QCA by 30 September following the relevant year:



Within the AT₂₋₄ and AT₅ Revenue Adjustment Amounts, there are six areas of allowable adjustments, provided for under Schedule F, Part B of the 2010AU.



In addition, Clause 3.3 of Schedule F, Part B of 2010AU allows Aurizon Network to claim an Increment if:

- the TAR for AT₂₋₄ is greater than the SAR for AT₂₋₄ for the relevant system; and
- the difference is the direct result of improved Below Rail network efficiency, in part or in whole, by Aurizon Network (or its contractors).

The QCA needs to be “reasonably satisfied³” of Aurizon Network’s rationale for the claim before allowing an Increment, the value of which may not exceed 2% of the relevant SAR. As discussed in section 1.3 above, Aurizon Network is not making an Increment claim for FY2015.

Once the FY2015 Revenue Adjustment Amounts have been approved, they will be adjusted for as part of the finalisation of the 2014DAU process, as outlined in the 2015 AAU.

2.3 The 2015 Amending Access Undertaking

During the QCA’s deliberation of the 2014DAU, and in order to provide pricing, revenue and cost certainty for Aurizon Network and access holders, Aurizon Network provided the 2015 AAU to the QCA for approval.

The 2015 AAU sought to:

- extend the term of the 2010AU from 30 June 2015 to 29 February 2016;
- finalise transitional revenues, volume forecasts and reference tariffs for FY2015;
 - transitional AT₂₋₄ and AT₅ SARs, volumes and reference tariffs remaining unchanged from the 2014 DAAU (adjusted for 2013 Flood review event);
 - exclude Rolleston AT₅ revenue and WIRP AT₂₋₅ revenue from TAR for FY2015 on the basis that these amounts were not included in the transitional SAR for FY2015;
 - confirm the basis on which any variation between actual and allowable revenues will be returned to, or recovered from access holders;
- establish transitional revenues, volume forecasts and reference tariffs for FY2016; and
- a range of other matters relating to FY2016 transitional tariffs.

The QCA approved the 2015 AAU on 5 June 2015 highlighting in Section 4.3 of the Final Decision that:

- any over (or under) recovery of revenues will be dealt with in the Final Decision on the 2014DAU; and
- the decision relates to the 2010AU and does not limit the QCA’s consideration of matters under the QCA Final Decision on the 2014DAU.

For clarity, it is intended that the Revenue Adjustment Amounts outlined in this submission will be incorporated into the finalisation of the 2014DAU.

³ Clause 3.3

2.4 Financial Model

A detailed financial model has been prepared and provided to the QCA in support of the FY2015 Revenue Cap submission. The model includes:

- Detailed billing data;
- The Take or Pay model; and
- calculations of the EC and rebate adjustments.

As the financial model contains specific information on individual Train Services and billing information on electricity costs, Aurizon Network claims confidentiality over the financial model which contains ringfenced information. Outputs from the models are summarised in this submission.

3 Revenue Adjustment Amounts for FY2015

3.1 Revenue Adjustment Amounts

Revenue Adjustment Amounts are caused primarily by actual throughput varying from the parameters underlying the regulatory system forecasts which form a key input in the determination of Reference Tariffs.

In FY2015, over 225 million tonnes were railed across the CQCR. This achievement reflects the sustained effort and aligned planning by all supply chain participants, including mines, ports, rail operators and Aurizon Network. As a result of these railings, tonnages in Blackwater, Goonyella and Newlands exceeded the system forecast approved by the QCA as part of the 2015 DAAU and resulted in over-recoveries of the relevant SARs for these systems.

A summary of regulatory forecast tonnage throughput and GTKs by system compared with actual tonnages and GTKs are provided in Tables 2 and 3 below.

| System | Forecast Tonnages (million NT) | Actual Tonnages (million NT) | Variance % |
|--------------|--------------------------------|------------------------------|------------|
| Blackwater | 60.2 | 62.8 | 4% |
| Goonyella | 106.4 | 119.6 | 12% |
| Moura | 13.1 | 12.2 | (7%) |
| Newlands | 14.0 | 14.7 | 5% |
| GAPE | 20.9 | 15.3 | (27%) |
| Total | 214.6 | 224.7⁵ | 5% |

Table 2 FY2015 Tonnage Performance

| System | Forecast GTK (billion) | Actual GTK (billion) | Variance % |
|--------------|------------------------|-------------------------|------------|
| Blackwater | 33.7 | 35.3 | 5% |
| Goonyella | 35.0 | 39.5 | 13% |
| Moura | 3.5 | 3.3 | (6%) |
| Newlands | 3.1 | 3.1 | (1%) |
| GAPE | 12.5 | 8.3 | (34%) |
| Total | 87.8 | 89.5⁴ | 2% |

Table 3 FY2015 GTK Performance

⁴ Excludes 0.9 million net tonnes and 0.6 billion GTKs to destination Wiggins Island Coal Export Terminal (WICET)

All systems with the exception of Moura and GAPE recorded an over-recovery of AT₂₋₄ SAR due to above system forecast volumes.

The Moura system recorded GTKs which were 6% lower than the system forecast resulting in an under-recovery of AT₂₋₄ revenues. Take or Pay did not trigger in Moura due to the actual GTKs being greater than the system forecast GTKs when adjusted for Aurizon Network Cause and Force Majeure cancellations.

GAPE system GTKs were 34% below the system forecast, triggering Take or Pay. The Take or Pay recovered the full extent of the AT₂₋₄ SAR under-recovery. As a result, no Revenue Adjustment Amount is required.

Whilst Blackwater GTKs were higher than the system forecast, an under-recovery of the AT₅ SAR was recorded in the system. This was due to a shortfall of electric GTKs, resulting from a lower percentage of electric trains railed compared to the system forecast.

The total of the Revenue Adjustment Amounts for FY2015, relative to FY2015 transitional SAR, represents a net return to Access Holders of \$27.6 million, comprising a return of \$25.3 million for AT₂₋₄ and a return of \$2.3 million for AT₅, varying between returns and recoveries at a system level.

The Revenue Adjustment Amounts for 'non-electric' and 'electric' are reconciled to the SAR and TAR as outlined below in Tables 4 and 5:

AT₂₋₄

| System | Adjusted System Allowable Revenues \$m | Total Actual Revenues \$m | Revenue Adjustment Amounts \$m |
|------------------|---|------------------------------|-----------------------------------|
| Blackwater | 247.2 | 255.5 | (8.3) |
| Goonyella | 234.8 | 253.9 | (19.1) |
| Moura | 40.6 | 37.8 | 2.8 |
| Newlands | 35.4 | 36.0 | (0.6) |
| Sub-Total | 558.0 | 583.3 | (25.3) |
| GAPE | 114.6 | 114.6 | - |
| Total | 672.6 | 697.9 | (25.3) |

Table 4 Revenue Adjustment Amounts – AT₂₋₄

AT₅

| System | Adjusted System Allowable Revenues \$m | Total Actual Revenues \$m | Revenue Adjustment Amounts \$m |
|--------------|---|------------------------------|-----------------------------------|
| Blackwater | 94.1 | 89.4 | 4.7 |
| Goonyella | 71.9 | 78.9 | (7.0) |
| Total | 166.0 | 168.3 | (2.3) |

Table 5 Revenue Adjustment Amounts – AT₅

A comparison with Revenue Adjustment Amounts (excluding cost of capital adjustments) for previous submissions is presented in Table 6:

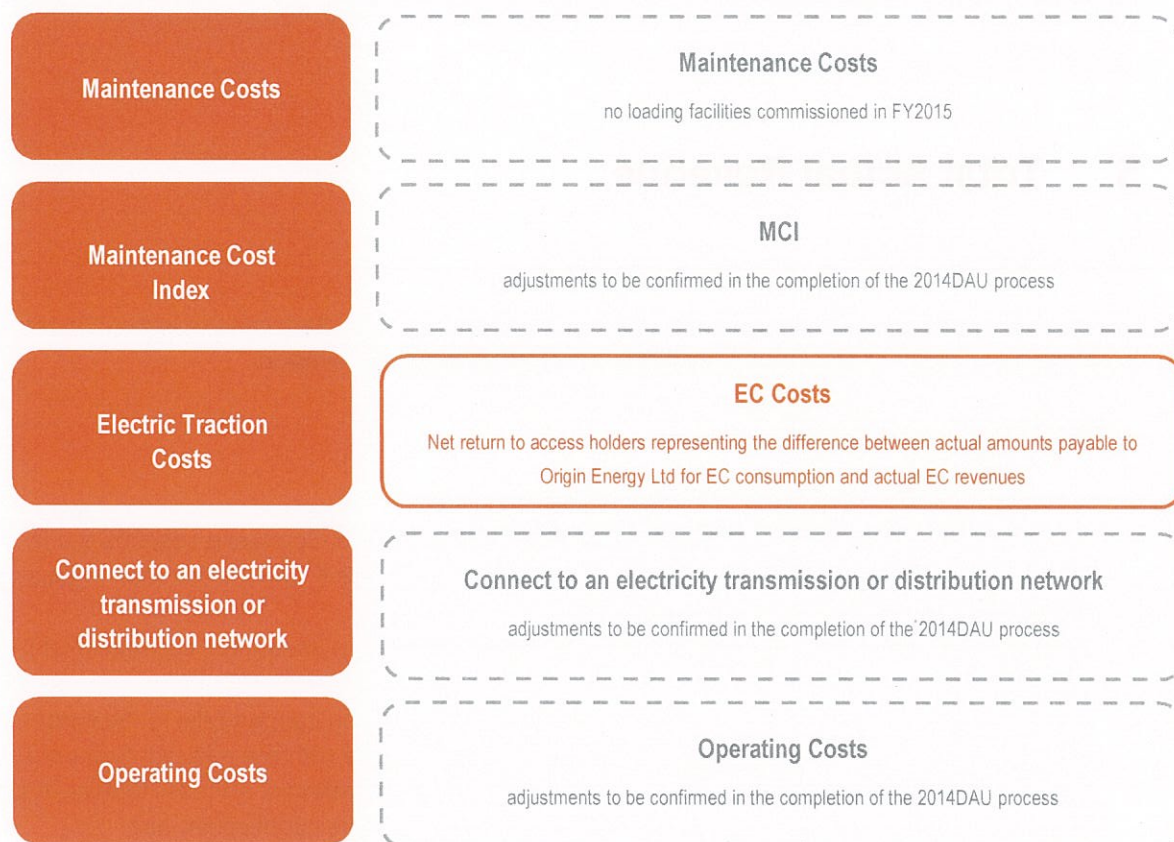
| Year | AT ₂₋₄ Adjustment \$m | AT ₅ Adjustment \$m | Total Adjustment \$m |
|------|-------------------------------------|-----------------------------------|-------------------------|
| 2007 | 15.7 | 10.1 | 25.8 |
| 2008 | 27.8 | 15.8 | 43.6 |
| 2009 | 4.6 | 28.3 | 32.9 |
| 2010 | (6.1) | 6.0 | (0.1) |
| 2011 | 19.2 | 30.0 | 49.2 |
| 2012 | 2.7 | 11.2 | 13.9 |
| 2013 | 28.2 | 10.9 | 39.1 |
| 2014 | 15.5 | (8.5) | 7.0 |
| 2015 | (25.3) | (2.3) | (27.6) |

Table 6 Total Revenue Adjustment Amounts – FY2007 to FY2015

4 Adjustments to SAR

The adjustments to SAR for FY2015 are limited to one of the five allowable areas, specifically the electric traction costs, with the remaining adjustments to be confirmed under the 2014DAU process.

Further detail is located within Attachment A and is detailed in the financial model accompanying this submission.



4.1 Electric Traction Costs

Aurizon Network has calculated a net return to Access Holders of \$3.1 million for EC costs from the difference between:

- amounts paid to Origin Energy Limited for the consumption of EC as per invoices⁵; and
- EC revenues for FY2015 for Goonyella and Blackwater⁶.

Aurizon Network notes that as WIRP segments are fully integrated with the existing mainline Blackwater infrastructure, it is difficult to separate EC costs and revenues. Therefore destination WICET EC costs and revenues have been included in the calculation of the net return EC adjustment.

⁵ Gross of regeneration credits that are returned to operators

⁶ Blackwater EC revenue includes revenue collected from QR Passenger Pty Ltd for electric 'Tilt Train' services on the North Coast Line, for which the comparable costs are reflected in the amounts paid to Origin.

| System | AT ₅ System Allowable Revenue Per Schedule F \$m | Adjustment \$m | Adjusted AT ₅ System Allowable Revenue \$m |
|--------------|--|-------------------|--|
| Blackwater | 94.2 | (0.1) | 94.1 |
| Goonyella | 74.9 | (3.0) | 71.9 |
| Total | 169.1 | (3.1) | 166.0 |

Table 7 Adjusted System Allowable Revenues – AT₅

5 Total Actual Revenue

5.1 Adjustments to Access Charges

The Access Charges payable by Access Holders for individual Train Services are set out in detail in the financial model that has been provided to the QCA with this submission.

Aurizon Network confirms that:

- Access revenues are per Aurizon Network's billing system;
- Allocations for cross-system traffics between the Blackwater and Goonyella systems are in accordance with both the cross-system pricing rules in Schedule F and the revenue adjustment process as applied in prior years' calculations;
- Access revenues exclude Rolleston AT₅ revenue and WIRP AT₂₋₅ revenues, consistent with the 2015 DAAU;
- Access revenues in the GAPE system include Take or Pay which capped fully to the extent of the AT₂₋₄ SAR. Take or Pay has been determined in accordance with the relevant Standard Access Agreement and has been agreed with and billed to the relevant Access Holders. A copy of the Take or Pay model has been provided to the QCA with this submission; and
- Blackwater access revenues include a transfer fee of \$0.04 million. No other relinquishment or transfer fees were collected, or were entitled to be collected, during FY2015.

5.2 Rebate Adjustments

The TAR includes the SAR for AT₂₋₄ and AT₅ for assets under a rebate agreement, less any rebates paid under that agreement. The rebate agreement includes an arrangement under an Access Facilitation Deed (AFD).

An adjustment may be required to the extent that the rebateable revenues within SAR vary from the rebates paid under the AFD. The adjustments are equivalent to the difference between actual and regulatory forecast tonnages for the mine covered by the AFD, multiplied by the relevant rebate rate per tonne.

The adjustments for rebates represents a net recovery from Access Holders of \$6.6 million:

- \$6.5 million for non-electric assets (AT₂₋₄), split between Blackwater (\$2.9 million), Goonyella (\$3.3 million) and Newlands (\$0.3 million); and
- \$0.05 million for electric assets (AT₅) in Goonyella only.

There are no rebate arrangements covering mines in the Moura and GAPE systems and for electric infrastructure in the Blackwater system.

6 Response to Stakeholder Submissions

Each of Asciano, Vale and the QRC provided a submission in response to Aurizon Network's Original Submission. These stakeholder submissions were published on the QCA website on 20 November 2015. Aurizon Network response to the issues raised in those stakeholder submissions is set out below.

6.1 Rebate Adjustments

Stakeholders expressed concerns over the treatment of rebates, in particular, the fact that any under or over payment of rebates throughout the financial year were trued up through the Revenue Adjustment Amount process. The primary concern is that under the 2010AU, the impact of rebate adjustments are not quarantined between Aurizon Network and the AFD Holder.

Similar concerns have been raised in respect of the 2014DAU. As a result, Aurizon Network anticipates that the QCA will seek to address this matter in its consolidated draft decision on the 2014 DAU.

For the purposes of this submission, however, the 2010AU process applies. Aurizon Network's treatment of rebates in this submission is consistent with the terms of the 2010AU and should be approved on that basis.

6.2 Forecasts

Stakeholders expressed concerns over the forecasts adopted for rebate mines and asked that they be reviewed by the QCA so that the risk of substantial rebate adjustments is minimised. In addition, stakeholders had concerns over the transparency of the general forecasting approach, particularly in relation to electric utilisation forecasts.

Aurizon Network ultimately has no control over the traction choices of above rail operators and relies on their input when setting forecasts for electric utilisation.

Aurizon Network would welcome greater input and engagement from all rollingstock operators with regards to establishing volume forecasts for the CQCR, but notes that it is the QCA that ultimately sets and approves the regulatory volume forecasts. The QCA approved forecasts are also applied to all rebate calculations.

6.3 WIRP Electric Costs

Some stakeholders expressed concerns about the treatment of EC revenue and costs related to WIRP Train Services. In particular, that a distinction should be made between WIRP and Non-WIRP Train Services operating in the Blackwater System with respect to the treatment of EC under the Revenue Adjustment Amount process.

Aurizon Network supplies electricity to the CQCR at cost through a voluntary provision in its Access Undertaking. Aurizon Network is billed for actual electricity usage by Origin Energy, however, Origin Energy does not have any means of determining whether the electricity was consumed by a Train Service travelling to the Wiggins Island Coal Export Terminal or to the other Gladstone terminals. As a result, any

attempts to conduct a separate EC true-up for WIRP and Non-WIRP Train Service would require an estimated cost allocation, which would add unnecessary complexity into the process, for immaterial benefit.

Aurizon Network notes that its 2014DAU proposes to remove the EC true-up from the Revenue Adjustment Amount process. Instead, Aurizon Network proposes that any EC variation will flow directly through to the forecast EC charge for the next year, subject to QCA approval.

Attachment A – Total Actual Revenues and Adjusted System Allowable Revenues (Schedule for Publication)

