

File Ref: 1397832

20 December 2019

Mr Nick Easy
Chief Executive Officer
Queensland Rail
GPO Box 1429
Brisbane Qld 4001

Dear Mr Easy

Queensland Rail Reference train characteristics DAAU

The Queensland Competition Authority (QCA) has approved Queensland Rail's draft amending access undertaking to increase the number of wagons and maximum train length of the reference train service in clause 2.1 of schedule D of the 2016 access undertaking (the reference train characteristics DAAU).

The QCA approved the reference train characteristics DAAU in accordance with ss. 142 and 143 of the *Queensland Competition Authority Act 1997*, having regard to the relevant statutory criteria and following consideration of submissions made by New Hope Group, Yancoal and Aurizon Coal.

These amendments reflect the result of successful trials of a longer 42-wagon coal trains on the West Moreton Network to better utilise locomotive hauling capability and increase above-rail productivity, and are largely supported by stakeholders.

The QCA noted Queensland Rail did not seek to make consequential changes to the reference tariffs to reflect the varied reference train service through this DAAU. Instead, Queensland Rail proposed that this be considered and dealt with as part of the September 2019 review event application (i.e. where any reduction in reference tariffs from running longer trains is offset against an increase in reference tariffs from lower forecast volumes).

The QCA noted stakeholders' concerns around using the review event process to make relevant adjustments to the reference tariffs from this DAAU, including the apparent lack of transparency around any adjustment to be made. Failing to make relevant adjustments through this DAAU could introduce an inconsistency between the reference tariffs that apply and the reference train service provided. However, the QCA has also made a decision to approve the September 2019 review event (which in effect realigns the reference tariffs with the approved reference train service) to reflect longer trains.

The QCA will publish this letter on its website for stakeholders' information.

Should you or your staff require more information please contact Pag Arao-Arao on (07) 3222 0560.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'C Millsted', is positioned below the 'Yours sincerely' text.

Charles Millsted
Chief Executive Officer

cc: *Mr Neil Buckley, General Manager Rail Access Solutions*

DECISION NOTICE

QUEENSLAND RAIL'S REVIEW EVENT – WEST MORETON AND METROPOLITAN NETWORK REFERENCE TARIFF

20 December 2019

The Queensland Competition Authority has made a decision to approve a variation of the West Moreton and Metropolitan Network reference tariff resulting from a review event.

Queensland Rail's application

On 23 September 2019, Queensland Rail applied to increase the West Moreton and Metropolitan Network reference tariffs applicable under a review event process, to account for:

- (1) the addition of an extra wagon to the reference train service consist
- (2) the forecast reduction in volumes as a result of:
 - (a) no new contracted paths or ad-hoc tonnes expected from 1 July 2019 to the end of the 2016 access undertaking (AU1) period, as forecast throughput remains low for the rest of 2019
 - (b) the reduction in the number of contracted train services from New Acland mine, as Stage 2 of the mine is forecast to exhaust coal production¹ within the next few years.

Queensland Rail said that the overall reduction in volume is expected to increase the West Moreton two-part tariff and Metropolitan tariffs as at 1 July 2019 and 1 January 2020, (in 2016–17 dollars) as set out in Table 1:

Table 1 West Moreton and Metropolitan Network Tariffs (\$2016-17)

<i>Tariff type</i>	<i>Current reference tariff: 1 July 2018</i>	<i>Proposed: 1 July 2019</i>	<i>Proposed: 1 January 2020</i>	<i>Current reference tariff: 1 July 2018</i>	<i>Proposed: 1 January 2020</i>
	West Moreton			Metropolitan	
Base tariff (gtk)	16.63	18.28	21.13	16.66	16.66
AT1 (gtk tariff) \$/'000 gtk	8.31	9.14	10.56	8.33	8.33
AT2 (train path tariff) \$/tp	2,965.51	3,376.83	4,294.25	1,148.69	1,173.75

¹ Queensland Rail, *Review Event 2019* (QR submission), pp. 1–4.

Stakeholder comments

We published Queensland Rail's proposal and received three submissions, from New Hope Group, Yancoal, and Aurizon Coal, in which stakeholders acknowledged the volume impacts² but were concerned that the resultant tariffs:

- did not take into account the likely decrease in Queensland Rail's costs that would be anticipated to arise from a reduction in volumes³
- did not appropriately factor in the increased train length⁴
- are not appropriate having regard to the section 138(2) factors of the QCA Act⁵, given the increase in reference tariffs is materially higher than the affordability limit of its customer(s)⁶
- lack transparency, because they combine the result of two events (where productivity improvements from longer trains will only slightly offset tariff increases from reduced volumes)⁷

Queensland Rail provided a response to stakeholders' comments (in accordance with sch. D cl. 5.3(b)).⁸

QCA assessment

We have assessed the review event application in accordance with Schedule D, clause 5 of AU1. We may only approve the review event application if:

- the identified review event has occurred, the variation has been calculated correctly and the proposed tariff reflects the cost impact on QR (sch. D cl. 5.4(a)(ii))
- it is appropriate to do so having regard to the QCA Act, including s. 138(2) (sch. D cl. 5.4(a)(iii)).⁹

We have separately considered a draft amending access undertaking Queensland Rail (Reference Train Service DAAU) seeking to change the characteristics of the reference train service.¹⁰

Pricing and volume risks under the 2016 AU

Queensland Rail's West Moreton system is regulated under a price cap regime. The price cap operates in conjunction with a capped take-or-pay mechanism whereby Queensland Rail can earn take-or-pay revenue on contracted paths up to an approved amount, known as the approved ceiling revenue limit.

This pricing framework is intended to balance the interests of access holders and seekers with the legitimate business interests of Queensland Rail. This balance seeks to ensure access holders and seekers benefit from lower tariffs and higher train path availability, whereas Queensland Rail benefits from higher tariffs and recovering its efficient costs (i.e. the costs of operating, maintaining and recouping sunk investments in its rail infrastructure).

² New Hope, *Review Event 2019*, p. 3; Yancoal, *Review Event 2019*, p. 9

³ New Hope, p. 3; Yancoal, p. 4

⁴ Yancoal, p. 3

⁵ Yancoal, p. 5

⁶ New Hope, p. 2

⁷ Aurizon Coal, *Queensland Rail's reference train service draft amending access undertaking and volume and reference train review event*, pp. 1-2.

⁸ Queensland Rail, *Review event application—request for response to industry comments*, (QR response).

⁹ These include promoting economically efficient operation of, use of and investment in regulated infrastructure, with the effect of promoting competition in related markets. They also encompass the legitimate business interests of Queensland Rail, access seekers and access holders and the public interest.

¹⁰ See <https://www.qca.org.au/project/queensland-rail/2016-access-undertaking/reference-train-service-daau/>

We accepted Queensland Rail's volume forecasts for both contracted and ad hoc paths in the 2016 AU, based on expected railings and prevailing conditions of the time. We recognised that Queensland Rail retained exposure to higher revenue if actual railings were above the forecast, but also to a revenue shortfall, particularly where ad-hoc railings or ad-paths are not expected to materialise.

Review event

New Hope acknowledged that its contracted access rights have reduced under its new access agreement¹¹.

Yancoal said that the addition of a wagon to the reference train service does not automatically constitute a review event requiring a variation to the reference tariff, and said that Queensland Rail has not sought to separate the impacts of the additional wagon from the reduction in train services.¹² Although these matters are linked, we have assessed, and approved, the Reference Train Service DAAU separately from this review event application. We consider that changing the reference train characteristics would be expected to lead to a change in reference tariff.

In addition, in a period where volumes are below system forecasts, particularly under continued volume uncertainty, the review event mechanism gives Queensland Rail recourse to recover efficient costs, where such an event is considered a material change in circumstance, unrelated to network capacity constraint, and one that gives rise to a need to vary the reference tariff.

Queensland Rail has highlighted that the change in contracted services in its access agreements reflect a material change in circumstances, consistent with previously submitted and approved review events, relating to the renegotiation of contracted train paths.¹³

We agree that the current lower contracted train services represents a material change in circumstances. Therefore, we consider that a review event has occurred, as the actual number of contracted services as at 1 July 2019 will be materially lower than the number used to set the pricing in the 2016 AU.

Cost impacts

New Hope and Yancoal said that Queensland Rail's submission provides no indication that, in calculating the proposed revised tariffs, Queensland Rail has taken into account the likely decrease in its costs.¹⁴

Queensland Rail has utilised allocations consistent with those previously approved for AU1 to adjust volume changes and subsequent effects on costs. The cost impact from a decrease in train services, while not material, does reflect the approved efficient costs and stakeholders' general acceptance of Queensland Rail's fixed costs.¹⁵

Moreover, we recognise the lag implicit in maintenance and operational cycle on Queensland Rail's costs particularly at this stage in the regulatory period. Queensland Rail said it needs to be given a reasonable time to adjust its fixed maintenance costs in response to a change in demand for train services¹⁶, particularly as the possibility of New Hope Stage 3 development continues to change.

We have assessed the information Queensland Rail supplied in support of its application including the adjustments to the reference tariffs. Our analysis has confirmed that the changes in contracted train services have flowed into the correct reference tariff adjustments.

¹¹ New Hope, p. 2

¹² Yancoal, p. 3

¹³ QCA, *New Hope review event—final decision*, July 2018.

¹⁴ New Hope, p. 3, Yancoal, p. 4

¹⁵ Yancoal, p. 4, New Hope, p.3

¹⁶ Queensland Rail, QR response, p. 3

Recognising the need for balance in addressing the s. 138(2) criteria

In determining whether to approve Queensland Rail's review event we have also assessed the application against section 138(2) of the QCA Act. This required us to balance competing factors, including setting prices that promote and reflect efficient operations and weighing those against customers' willingness and ability to pay.

Affordability

Yancoal said that it is not appropriate for the volume risk arising from New Hope's difficulty in obtaining regulatory approvals for New Acland Stage 3 to be principally borne by Yancoal¹⁷, while New Hope said that Queensland Rail has substantially over-estimated the ability to pay of West Moreton coal miners.¹⁸

While we have had regard to affordability and market conditions to the extent that they affect matters including the current utilisation of the network, we also note that there are competing considerations. These include, whether the price of access generates expected revenue that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved. Providing regulatory predictability and certainty in the regulatory process and its outcomes, achieved by applying commonly accepted regulatory methodologies consistent with the approval criteria is also important.

We understand that variability occurs in the short-term in customers' ability to pay, especially given the typical volatility in coal export markets. However, we consider that if, in response to affordability concerns, the tariff is not increased to reflect the volume change, Queensland Rail might face increased risk in recovering its efficient costs, reducing its incentive for long-term investments.

Therefore, it would not be an appropriate balance of, among other things, the interests of Queensland Rail, the public interest, the pricing principles and the interests of access seekers and access holders, for prices to be set in a manner that gives greater weight to supporting the profitability of access holders or seekers and their customers over the regulatory predictability and certainty that will come from applying the transparent tariff methodology established in the undertaking.

Asset optimisation, revenue deferral and the interests of access seekers, access holders and Queensland Rail

Yancoal and New Hope said that the proposed tariff increase is not in Queensland Rail's long-term interests as 'revenue maintenance' will result in a material spike in prices at the very time when volumes are low and customers are most economically vulnerable. This also presents real threats to the prospects of volume returning¹⁹, damages the prospects of future investment in New Acland, threatens the economic viability of Cameby Downs²⁰ and impacts the long-term sustainability of coal haulage in the West Moreton system.²¹ New Hope and Yancoal said that excluding existing assets through optimisation or other mechanism such as revenue deferral measures, was required to ensure tariffs remain affordable.²²

While we consider that these options may be relevant where volumes remain low, we have not required that Queensland Rail adopt these as the end of the current undertaking period approaches. Each option has long-term consequences that are better dealt with as part of the wider discussion for the 2020 DAU where consideration of the long-term impacts of demand constraints, network asset utilisation for coal services, and the uncertainty of future volumes' on tariffs are undertaken.

¹⁷ Yancoal, p. 1

¹⁸ New Hope, p. 4-5

¹⁹ Yancoal, p. 8

²⁰ New Hope, p. 6

²¹ Aurizon Coal, Review Event 2019, p. 2

²² Yancoal, p. 8-10, New Hope, p. 2, 6

In any given regulatory period, tariff increases or decreases are contingent on network demand and actual volume throughput. An endorsed variation event requires Queensland Rail to reduce tariffs where contracted train paths exceed the volume forecasts used to calculate the approved prices. This reflects the reduced risk for Queensland Rail when access holders contract for access, rather than using ad hoc services.

There is no provision in the undertaking that provides specifically for an opposite effect, whereby the increased risk from lower contracted volumes is reflected in a higher tariff. However, Queensland Rail has sought to achieve this through its review event application.

We consider it is appropriate for Queensland Rail to make such a proposal. Just as higher contracted volumes reduce its risk, lower contracted volumes increase the risk it bears, as it has a lower level of guaranteed revenue (i.e. take-or-pay). A symmetric approach would encourage consistent access holder behaviour in that there is always an incentive to contract for paths they reasonably expect to use, as they will benefit from lower prices.

While we have kept the size of the reduction in contracted services confidential, we consider that it is material to Queensland Rail's expected cashflows, and therefore its risk profile.

We consider that the tariff variation arising from the review event is likely to:

- give Queensland Rail greater certainty it will recover more of its efficient costs, which promotes its legitimate business interest and has regard to the pricing principles (s. 138(2)(b),(g))
- encourage access holders and seekers to increase contracted paths to reduce the tariff, in line with expected demand, providing certainty and promoting efficient pricing which is in the public interest (s.138(2)(d))
- promote the efficient use of, operation of and investment in rail infrastructure (s.138(2)(a)) by:
 - encouraging access holders who efficiently use rail infrastructure to reflect this behaviour in their contracting rather than risk under-contracting and being exposed to ad hoc path availability
 - encouraging Queensland Rail to efficiently invest in and operate rail infrastructure as it receives sufficient revenue for the investment risk

We have reviewed Queensland Rail's submitted model and confirmed that the revised tariffs are correctly calculated.

Decision

We have assessed the review event application against the matters set out in Schedule D, clause 5.4(a)(ii) and (iii), and consider that the application is consistent with the undertaking. In particular:

- the event has occurred
- the reference tariff is calculated as if all reference tariffs have been recalculated
- the proposed tariff reflects the cost impact on Queensland Rail
- the proposed variation is appropriate to approve with regard to the criteria set out in section 138(2) of the QCA Act.

For the reasons set out above, we have made a final decision to approve this proposed review event tariff variation.