Queensland Competition Authority

File Ref: 1415298

28 May 2020

Ms Pam Bains
Group Executive Network
Aurizon Network
GPO Box 456
Brisbane Qld 4001

Dear Ms Bains

**Annual review of reference tariffs—2020–21**

The Queensland Competition Authority approved Aurizon Network's proposed 2020–21 allowable revenues and reference tariffs as a result of its annual review of reference tariffs application.

The attached decision constitutes a notice per schedule F, clause 5.5(d) of the 2017 access undertaking, and sets out the basis for our decision.

We will publish this letter and decision on the QCA website for stakeholders' information.

Yours sincerely

Charles Millsteed
Chief Executive Officer

Queensland Competition Authority

# DECISION NOTICE

## ANNUAL REVIEW OF REFERENCE TARIFFS

28 May 2020

The Queensland Competition Authority approves Aurizon Network's proposed variations to its volume forecast, maintenance and capital indicator, tax allowance and consequential adjustments to its 2020–21 allowable revenues and reference tariffs. The reasons for this decision are set out in this notice, in accordance with Aurizon Network's 2017 access undertaking.

## Background

Schedule F of Aurizon Network's 2017 access undertaking (2017 AU) provides a mechanism for Aurizon Network to adjust its reference tariffs prior to the beginning of each financial year. Under clause 5.1(a)(ii)(B), Aurizon Network must submit a reference tariff variation to the QCA by 28 February each year, in accordance with clause 4.1(a) of the undertaking. This allows Aurizon Network to update the system allowable revenues and reference tariffs (cl. 4.1(b)(vii)), to reflect the actual change or updated changes in defined factors that impact reference tariffs.

On 28 February 2020, Aurizon Network submitted its proposed reference tariffs and allowable revenues for 2020–21 for approval.

## Aurizon Network's proposal

Aurizon Network[1] has applied adjustments to volumes, allowable revenues and reference tariffs for each coal system. These adjustments are based on schedule F provisions that allow for:

- adjusting for any under- or over-recovery of the revenues (revenue cap) if any, and the difference between approved capital expenditures and the capital indicator in previous years (cls. 4.1(a)(i)–(ii))
- updating volume forecasts—used to determine reference tariffs (cls. 4.1(b)(i)–(ii))
- updating the maintenance and capital indicator for each coal system to reflect the approved maintenance and renewals strategies and budgets (cls. 4.1(b)(v) and 4.1(b)(vi))
- updating the tax allowance to reflect the changes proposed to revenues (cl. 4.1(b)(vii)(F))
- incorporating approved forecast Independent Expert (IE) pass-through costs (cl. 4.1(b)(viii))

[1] Aurizon Network, *Annual Review of Reference Tariff*—FY2021, February 2020 (Aurizon Network proposal).

- updating electric infrastructure and electric energy charges to reflect the latest forecast of transmission and energy forecasts (cls. 4.1(c)(ii) and 2.2(a)).

This year, Aurizon Network did not seek to make an adjustment for the revenue cap (as this had already been incorporated in Aurizon Network's consolidation DAAU, approved in February 2020[2]) or the forecast IE pass-through costs (as the IE had not advised Aurizon Network of the forecast IE amounts at the time it made its application).

Aurizon Network provided the methods, data and assumptions used to determine the proposed variations via detailed financial models supporting the proposed amendments.

## Stakeholder comments

We published details of Aurizon Network's proposed reference tariff variation and invited and considered comments from stakeholders regarding the proposed variation. We received two submissions, from Rio Tinto and QCoal, as well as a response to these submissions from Aurizon Network.

QCoal and Rio Tinto both raised concerns about the proposed capital indicator for the Newlands system. In particular, they considered the proposed capital indicator had been inappropriately allocated entirely to the Newlands system (with no allocation to the Goonyella to Abbot Point system), and they mentioned that Aurizon Network did not provide any details on how these costs were apportioned nor any justification for this approach.[3]

In response, Aurizon Network maintained that its proposed approach should be adopted, as it aligned with past practice, having regard to the nature of the forecast works, and given the material difference in access charges that exist between Newlands and Goonyella to Abbot Point system users.[4]

## 2017 AU criteria and QCA assessment

We are required to assess Aurizon Network's proposal against the requirement for the annual review of reference tariffs (cl. 4.1). This includes having regard to whether the revised volume forecasts are reasonable (with no errors made); the submitted maintenance and capital indicators are consistent with the approved indicators; the revised tax allowance has been calculated correctly; and no errors have been made in adjustments to allowable revenues or reference tariffs.

## Volume forecasts

Aurizon Network has proposed updated 2020–21 volumes forecasts and associated gross tonne kilometre (gtk) forecasts that we consider are reasonable.

In its proposed system forecasts for the Central Queensland coal network (CQCN), Aurizon Network said that the variances in its forecasts came down to timing differences[5] between when actual railings are recorded, the deadline to submit reference tariffs, and when maintenance and renewal budgets and strategies are set. This can affect forecast accuracy.[6]

We acknowledge the difficulty of predicting volumes under current levels of uncertainty and consider that the proposed revised volumes better reflect 'prevailing market conditions'. We note the proposed volume forecast

[2] QCA, *Consolidation DAAU*, decision, February 2020.

[3] QCoal, submission to the QCA, *Aurizon Network annual reference tariffs review*, March 2020; Rio Tinto, submission to the QCA, *Aurizon Network annual reference tariffs review*, March 2020.

[4] Aurizon Network, *Annual Review of Reference Tariffs FY21—Response to stakeholder submissions*, April 2020 (Aurizon Network response), p. 3.

[5] Aurizon Network proposal, p. 7.

[6] Aurizon Network proposal, p. 7.

methodology is consistent with previous practice and the updated railing information reconciles with information that is publicly available.

Accordingly, we approve Aurizon Network's proposed volume forecasts.

**Table 1 Volume forecasts, 2020–21**

| *System* | *Current (mt)* | *Proposed(mt)* | *Variance (mt)* |
|---|---|---|---|
| Blackwater | 69.2 | 66.1 | 3.1 |
| Goonyella | 131.5 | 124.5 | 6.9 |
| Moura | 16.5 | 16.5 | |
| Newlands | 13.2 | 13.2 | |
| GAPE | 18.9 | 18.9 | |
| **Total** | **249.2** | **239.2** | **10.0** |

## Capital expenditure

We approved Aurizon Network's 2017–18 capital expenditure[7] of $212.6 million and the subsequent roll-forward into the regulatory asset base in 2019.[8]

We approve this adjustment being reflected in allowable revenues comprising components for return on capital, return of capital (depreciation) and tax depreciation. The 2017 AU (schedule F, 4.1(a)(ii) and calculated in accordance with schedule E, clause 5(b)[9]) allows inclusion of an adjustment reconciling the difference between the approved capital expenditure and the capital indicator for the year in which that relevant capital expenditure was incurred.

We consider that allowable revenues attributable to capital expenditure inclusion of the 2017–18 into the regulatory asset base are appropriately captured and accounted for in this application. Aurizon Network updated its financial models for the approved capital expenditure and the roll-forward mechanism and reflected the relevant adjustments in allowable revenues by applying the approved discount rate accrued. This inclusion resulted in an increase in the allowable revenue in 2020–21 of $7.1 million for non-electric assets, and $0.2 million for electric assets.

## Maintenance indicator allowance

Aurizon Network has proposed maintenance indicator allowances that are consistent with its Maintenance Strategy and Budget[10], which was approved by a special majority of end users of the Moura, Blackwater, Goonyella and Newlands/GAPE coal systems.

[7] QCA, *Aurizon Network's 2017–18 capital expenditure claim*, decision, October 2019.
[8] QCA, *Aurizon Network's 2017–18 RAB roll-forward*, final decision, December 2019.
[9] Clause refers to allowable revenue adjustments resulting from capital expenditure reconciliation
[10] Aurizon Network, *Aurizon Network Maintenance and Renewal Strategy and Budget*, 21 January 2020.

**Table 2 Maintenance indicator allowance, by coal system**

| ***Maintenance indicator*** | ***Allowance ($m)*** |
|---|---|
| Blackwater | 66.8 |
| Goonyella | 64.4 |
| Moura | 13.0 |
| Newlands | 3.2 |
| GAPE | 11.4 |
| **Total[a]** | **158.9** |

**a** *In Aurizon Network's Maintenance and Renewals Strategy and Budget (p. 8), $148.7 million refers to direct maintenance only.*

*Source: Aurizon Network proposal, p. 12.*

Where the proposed maintenance indicator allowance is consistent with the approved maintenance strategy and budget, we are required to approve the proposed maintenance indicator allowances (cl. 7A.11.4(a)(ii)). These maintenance indicator provisions were collaboratively agreed between coal producers and Aurizon Network during the UT5 DAAU process.

Accordingly, we approve Aurizon Network's proposed maintenance indicator allowances.

## Capital indicator allowance

Aurizon Network has proposed capital indicator allowances that are consistent with its Renewals Strategy and Budget[11], which was approved by a special majority of end users of the Moura, Blackwater, Goonyella and Newlands/GAPE coal systems.

**Table 3 Capital indicator allowance**

| ***Capital indicator^*** | ***Allowance ($m)*** |
|---|---|
| Blackwater | 116.1 |
| Goonyella | 113.5 |
| Moura | 15.4 |
| Newlands | 21.4 |
| GAPE | 0.0 |
| **Total[a]** | **266.4** |

***a*** *In its submission and modelling, Aurizon Network used 'start of year' terms (Total: $258.3 million).*

*Source: Aurizon Network's Maintenance Strategy and Budget and Renewals Strategy and Budget, January 2020, p. 8.*

Where the proposed capital indicator allowance is consistent with the approved renewals strategy and budget, we are required to approve the proposed capital indicator allowances (cl. 7A.11.4(c)(ii)). These capital indicator provisions were collaboratively agreed between coal producers and Aurizon Network during the UT5 DAAU process.

Accordingly, we approve Aurizon Network's proposed capital indicator allowances.

In relation to matters raised as to the allocation of renewals expenditure between the Goonyella to Abbot Point system and the Newlands system, this will be determined as part of the assessment of subsequent capital

[11] Aurizon Network, *Aurizon Network Maintenance and Renewal Strategy and Budget*, 21 January 2020.

expenditure claims (schedule E). In doing so, it is expected that Aurizon Network will outline the extent to which capital expenditure incurred on the Newlands system is an 'incremental cost' as defined in Aurizon Network's 2017 AU. We note that incremental costs include both renewal and expansion capital costs that would not be incurred (including the costs of bringing expenditure forward in time) if the train service did not operate.

This approach is consistent with Aurizon Network's 2017 AU provisions as they relate to system reference tariffs; the definition of the Goonyella to Abbot Point system (which includes rail infrastructure that is used by a train service that also uses the Goonyella Newlands Connection); and the principles of cost allocation as they relate to incremental costs.

We expect that Aurizon Network will continue to work collaboratively with all participants of the Rail Industry Group in order to develop an appropriate approach to allocate the incremental cost of renewals on the Newlands system due to Goonyella to Abbot Point system traffics bringing forward such capital expenditure.

### Other—electric transmission costs, the EC and tax allowance

#### Electric transmission and energy costs

We consider Aurizon Network's proposal to pass through the latest pricing change from its transmission network service providers (TNSP) to customers is reasonable. We note that the updated 2020–21 connection and transmission charges are lower than originally forecast in the 2017 AU.[12]

Aurizon Network updated both electric transmission charges and the electric energy costs for 2020–21 for running its electrified infrastructure, in line with new information received. Electric transmission connection charges are determined by the AER and negotiated by Aurizon Network (chargeable through the AT5 tariff) for customers of its electric assets. Similarly, the EC tariff relating to the consumption of electric energy is set to recover the forecast costs included in the 2017 AU.

We consider it reasonable that Aurizon Network also reflected the latest pricing notification on the electric energy charges (EC), and the impact of this on the proposed 2020–21 volume reset, so that the lower than originally forecast result, is included. For clarity, Aurizon Network said that the proposed electric energy charges included an updated forecast of variable TNSP costs, as provided for in the 2019 Electric Traction DAAU.[13]

#### Tax allowance

The tax allowance is a computation of Aurizon Network’s post-tax revenue model. We consider that Aurizon Network has correctly accounted for it, in order to reflect all the proposed changes in the calculation of updated allowable revenues and reference tariffs for 2020–21.

## System allowable revenues

We consider that the proposed updates satisfy cl. 5.5(h)(ii) of schedule F, which requires the inclusion of revised gtk forecasts and allowable revenues to the extent applicable to that reference tariff variation.

[12] Aurizon Network proposal, pp. 14–15.
[13] QCA, *2019 Electric Traction DAAU*, decision, July 2019.

**Table 4 System allowable revenues, 2020–21**

| *System* | *Non-electric allowable revenues ($m)* | *Electric allowable revenues ($m)* |
|---|---|---|
| Blackwater | 357.9 | 76.6 |
| Goonyella | 282.6 | 65.9 |
| Moura | 49.9 | |
| Newlands | 32.2 | |
| GAPE | 124.7 | |
| **Total** | **847.3** | **142.5** |

## 2020–21 reference tariffs

We consider that Aurizon Network's updates to key variables are reflected in its financial models, supporting materials and in the corresponding changes to the reference tariffs for 2020–21.

**Table 5 Reference tariffs, 2020–21 ($)**

| *System* | *AT1* | *AT2* | *AT3* | *AT4* | *AT5* | *EC* | *QCA levy* | *Independent Expert fee* |
|---|---|---|---|---|---|---|---|---|
| Blackwater | 0.97 | 2,373.51 | 6.86 | 2.45 | 2.85 | 0.82 | 0.01004 | 0.00 |
| Goonyella | 0.67 | 1,503.76 | 4.86 | 0.99 | 1.71 | 0.82 | 0.01004 | 0.00 |
| Moura | 1.80 | 702.97 | 8.62 | 1.40 | -- | -- | 0.01004 | 0.00 |
| Newlands | 1.88 | 317.88 | 9.25 | 1.18 | -- | -- | 0.01004 | 0.00 |
| GAPE | 1.51 | 14,756.57 | 1.35 | 1.95 | -- | -- | 0.01004 | 0.00 |

## References

Aurizon Network, Aurizon Network Maintenance and Renewal Strategy and Budget, 21 January 2020.

——*Annual Review of Reference Tariff*s*—FY2021*, February 2020.

——*Annual Review of Reference Tariffs FY21—Response to stakeholder submissions*, April 2020.

QCA, *2019 Electric Traction DAAU*, decision, July 2019.

——*Aurizon Network's 2017–18 capital expenditure claim*, decision, October 2019.

——*Aurizon Network's 2017–18 RAB roll-forward*, final decision, December 2019.

——*Aurizon Network's Consolidation DAAU*, decision, February 2020.

QCoal, submission to the QCA, *Aurizon Network annual reference tariffs review*, 27 March 2020.

Rio Tinto, submission to the QCA, *Aurizon Network annual reference tariffs review*, 27 March 2020.