George Passmore
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane, Queensland, 4000

Annual Review of Reference Tariffs FY21 – Response to Stakeholder Submissions

27 April 2020

Dear George

On 28 February, Aurizon Network submitted proposed variations to Allowable Revenues and Reference Tariffs for the Financial Year commencing 1 July 2020 and ending 30 June 2021 (**FY2021**). The Annual Review of Reference Tariffs submission (**Submission**) was made in accordance with Schedule F, Clause 4 of the 2017 Access Undertaking (**UT5**).

The Queensland Competition Authority (**QCA**) received two submissions from stakeholders in relation to Aurizon Network's proposal; one from the QCoal Group (**QCoal**), another from Rio Tinto. Both submissions raised concerns about the proposed Capital Indicator for the Newlands System of $20.7 million (**m**); specifically, the allocation (or lack thereof) of forecast capital expenditure between Newlands and Goonyella to Abbot Point Expansion (**GAPE**) users.

Aurizon Network would like to take this opportunity to:

- respond to the key matters raised in each stakeholder submission; and
- articulate the rationale as to why GAPE users should not have to make a contribution towards the Asset Replacement and Renewal Expenditure for common user infrastructure in the Newlands system.

1. Current QCA-approved Capital Indicator

QCoal's submission correctly notes that the current Capital Indicator for FY21 includes a forecast of $6.7m for the Newlands system and $1.9m to GAPE; a total value of $8.6m[1]. These amounts were approved by the QCA in its Final Decision on the UT5 Draft Amending Access Undertaking (**DAAU**) on 19 December 2019.

[1] Schedule K, Aurizon Network, 2017 Access Undertaking, Revised UT5 DAAU, December 2019.

Aurizon Network wishes to clarify that the QCA-approved Capital Indicator for GAPE did not include any allocation of forecast Asset Replacement and Renewal Expenditure in the Newlands system. The revised Capital Indicator proposed in Aurizon Network's Submission is consistent with this QCA-approved approach in the DAAU.

Furthermore, the QCA-approved Capital Indicator for GAPE ($1.9m) was directly attributable to only the capitalisation of Ballast Undercutting expenditure, as outlined in the QCA's Final Decision on Aurizon Network's 2017 Draft Access Undertaking[2].

When preparing the revised Capital Indicator for the Submission, Aurizon Network sought to identify whether any ballast undercutting scope was planned on GAPE Rail Infrastructure.

Aurizon Network's Asset Management and Mechanised Production teams reviewed the planned locations of ballast undercutting works for FY2021. They confirmed that no ballast undercutting scope is expected to be completed on GAPE Rail Infrastructure during FY2021.

Consequently, Aurizon Network's Submission did not allocate any Ballast Undercutting costs to GAPE for FY2021 as they are not incremental to GAPE users.

2. The GAPE Reference Tariff is an Expansion Tariff

The pricing arrangements for GAPE Train Services were approved by the QCA during the term of Aurizon Network's 2010 Access Undertaking (**UT3**). At that time, the Access Undertaking did not include a defined framework for setting access charges for coal carrying Train Services that required an Expansion. Rather, the UT3 drafting[3] primarily contemplated expansions in the context of a new coal mine to existing Rail Infrastructure within the Central Queensland Coal Region.

Given the materiality of the GAPE project (a billion-dollar, multi-user expansion), the QCA's approval of the GAPE Draft Amending Access Undertaking[4] established GAPE as a new individual Coal System with its own Allowable Revenue and Reference Tariffs.

It should be noted that:

› 40% of the total value of the GAPE project related to the construction of the GAPE Link; the Rail Infrastructure built between North Goonyella and Newlands junctions;

› 55% of the total value of the GAPE project related to infrastructure improvements in the Newlands system, including the cost of Newlands system asset renewals that would otherwise have been required by incumbent users of the Newlands system. The construction of such renewals was brought-forward to accommodate the additional GAPE volume that was forecast to traverse this common-user infrastructure; and

› 5% of the GAPE project costs were attribution to Goonyella system enhancements.

As a result of the above, for all intents and purposes, the GAPE Reference Tariff is an Expansion Tariff of the Newlands System. It also ensures that GAPE users pay an Access Charge that reflects the full cost of Rail Infrastructure constructed during the GAPE project. This includes the cost of the aforementioned Newlands system track improvements which,

[2] Decision 3.3, Queensland Competition Authority, Decision Aurizon Network's 2017 draft access undertaking, December 2018, pg. 44.

[3] QR Network's 2010 Access Undertaking, cl 6.4.2.

[4] Queensland Competition Authority, Final Approval: June 2013 GAPE DAAU, File Ref: 631790, September 2013.

while geographically located in the Newlands system and utilised by GAPE and Newlands users, are not included the Newlands system Regulatory Asset Base (**RAB**).

In this context, in determining the treatment of the forecast Asset Replacement and Renewal Expenditure included in the Submission, clause 6.4.8 (a) of UT5 is highly relevant. It states that:

"...all Asset Replacement and Renewal Expenditure in respect of capital expenditure projects relating to a Coal System must only be included in the capital costs relevant to the calculation of the System Reference Tariff."

Aurizon Network's interpretation of the above, is that all Asset Replacement and Renewal Expenditure on common-user infrastructure in the Newlands system, should be included within the Newlands system Reference Tariff, and not within the GAPE expansion tariff.

Aurizon Network confirms that the entirety of the Newlands Capital Indicator proposed in Aurizon Network's Submission relates to works that are to be undertaken on common-user Rail Infrastructure located to the north of Newlands junction. In other works, all forecast works are required in the Newlands system and not the GAPE Link. Consequently, and consistent with clause 6.4.8 (a), the forecast Asset Replacement and Renewal costs relevant to the Newlands Rail Infrastructure have been included in the Newlands System Reference Tariff.

3. While apportionment between Newlands and GAPE does not reflect usage of the asset, it is appropriate in the context of Access Charges paid by two classes of users operating on common-user Rail Infrastructure

The submissions of both QCoal and Rio Tinto note that the allocation of asset renewal costs between systems does not reflect the usage of the assets.

Aurizon Network acknowledges that Newlands Rail Infrastructure is common to both Newlands and GAPE train services. Similarly, all Newlands users utilise GAPE project Rail Infrastructure constructed north of Newlands Junction.

While QCoal's submission correctly highlights that traffic volume and axle load is a factor taken into consideration when determining the scope of 'Structures' renewals, it is not the only determinant. Factors such as age, asset condition, asset criticality and environmental conditions (such as weather, soil etc) are also very relevant considerations. It would not be reasonable to assess such costs as incremental to GAPE Train Services as the works are unlikely to be avoided in the absence of GAPE volumes.

It should be noted that the GAPE access charge already includes a substantial allocation of Newlands system maintenance and operating expenditure, to reflect the impact of GAPE Train Services on this common user infrastructure in the Newlands system.

Nevertheless, Aurizon Network maintains that in the absence of any future expansion volumes, GAPE users should continue to pay the GAPE expansion tariff and should not be required to pay a further contribution towards the Asset Replacement and Renewal cost of common-user Newlands system Rail Infrastructure. In the event that there are future additional volumes, the applicable Reference Tariffs will have to be submitted and subsequently reviewed as part of a further Draft Amending Access Undertaking.

In addition to the factors outlined above, a key reason for this is the material pricing differential that exists between Newlands and GAPE for their use of the same common infrastructure.

As noted in section 2 above, 55% of the total value of the GAPE project related to infrastructure constructed in the Newlands system. To facilitate a meaningful comparison of access charges paid by both GAPE and Newlands Train Services, Aurizon Network has determined the average access charge that is paid by each type of Train Service for their use of common-user infrastructure in the Newlands system.

For Newlands Train Services, Aurizon Network has used the average FY21 access charge proposed in its Submission, including the full Capital Indicator.

For GAPE Train Services, Aurizon Network has:

- removed all infrastructure costs associated with the GAPE Link;
- removed all infrastructure costs associated with the Goonyella System Enhancements; and
- estimated the proportion of GAPE Gross Tonne Kilometres (GTK) that relates solely to Newlands system infrastructure[5].

As a result, the average access charge for GAPE and Newlands Train Services can be expressed as follows:

Table 1: Average Access Charge for common-user Newlands Rail Infrastructure only

FY21	Revenue ($m)	Net Tonne (NT)	$ per NT	$ per GTK
GAPE Train Services	80.5^	18.9	4.27	15.75
Newlands Train Services	37.3	13.2	2.83	13.90

^ *Excludes revenue attributable to the GAPE Link and Goonyella System Enhancements.*

On average, GAPE Train Services pay a regulated access charge that is:

- 50% higher on a $ per NT basis; or
- 13% higher on a $ per GTK basis,

than the amount paid by Newlands Train Services for their utilisation of the same common-user rail infrastructure. This material price differential would only widen (to the detriment of GAPE users) where they are also required to pay a material share of the Asset Replacement and Renewal costs of Newlands system Rail Infrastructure.

Aurizon Network would welcome the QCA's independent review of these calculations and would be happy to discuss this matter in further detail with QCA staff.

Increasing the GAPE Reference Tariff in the manner suggested is likely to be contrary to the Objectives of Part 5 of the Queensland Competition Authority Act, in the sense that it will:

- disincentivise the efficient utilisation of GAPE Rail Infrastructure; and
- will not promote effective competition in downstream markets; in particular, the competitiveness of Abbot Point Coal Terminal relative to both Dalrymple Bay Coal Terminal and Hay Point Coal Terminal for mines based in the Goonyella system.

[5] Aurizon Network has estimated this by applying the haul distance of the Newlands mine (the longest haul in the Newlands system), to all GAPE hauls.

In its final decision on Aurizon Network's 2016 Access Undertaking (UT4), the QCA accepted that GAPE users should not receive an allocation of common costs from the Newlands or Goonyella systems, noting that:

"Given that expanding users would already be paying access charges that are higher than the access charges faced by existing users, we considered it reasonable that expanding users not make a contribution towards common costs. A requirement to pay common costs would impose an additional burden that could dissuade investment."[6]

And that:

"Given that GAP system access charges remain significantly higher than existing Goonyella and Newlands access charges, we considered it reasonable that GAPE customers continued to only pay their incremental system costs over UT4."[7]

As detailed above in table 1, GAPE Train Services pay an Access Charge which:

› is higher than that paid by Newlands Train Services for the use of the same common-user Rail Infrastructure;
› includes a material contribution towards the maintenance and operating costs of the Newlands system; and
› includes the full cost of both the GAPE Link and the Goonyella System Enhancements.

The resulting aggregate Access Charge remains significantly higher than existing Goonyella and Newlands access charges, therefore application of this QCA statement from the UT4 final decision remains relevant.

4. Methodology applied for the apportionment of the Capital Indicator

QCoal's submission seeks a clear statement on the methodology to be applied to the current and future apportionment of the Capital Indicator between Newlands and GAPE.

Aurizon Network's position is as follows:

- all Asset Replacement and Renewal Expenditure on the GAPE Link should be included in the GAPE Capital Indicator; and

- all Asset Replacement and Renewal Expenditure on common-user Rail Infrastructure geographically located in the Newlands system should be included in the Newlands Capital Indicator.

Until such time as the pricing differential between GAPE and Newlands Train Services reduces to a more reasonable level, Aurizon Network considers it appropriate that GAPE users are not required to make a contribution towards the Asset Replacement and Renewals Expenditure of common-user Newlands system Rail Infrastructure. Aurizon Network believes that this approach is consistent with past QCA decisions, and clause 6.4.8 of UT5.

---

[6] QCA, Final Decision; Aurizon Network 2014 draft access undertaking; Volume 3 – Pricing & Tariffs; April 2016; pg. 116

[7] QCA, Final Decision; Aurizon Network 2014 draft access undertaking; Volume 3 – Pricing & Tariffs; April 2016; pg. 123-124

Recognising that this matter is of interest to some customers, Aurizon Network will endeavour to provide a greater transparency around the proposed cost allocations in future consultations.

5. Annual capital expenditure reconciliation

Finally, it should be noted that Aurizon Network's Submission sets a *forecast* Capital Indicator value for each individual Coal System.

By 30 October 2021, in accordance with UT5, clause 7A.11.6, Aurizon Network must submit a Renewals Capex Claim for FY2021 to the QCA for approval.

If the QCA-approved ex-post capital expenditure for FY2021 differs from the forecast Capital Indicator (for instance, where Asset Replacement and Renewals expenditure is incurred on the GAPE Link and therefore deemed by the QCA to be incremental to GAPE Train Services), UT5, Schedule E, clause 5(b) provides for a Capital Expenditure Allowable Revenue Adjustment, which will ensure that such capital costs incurred are ultimately borne by those paying the GAPE Reference Tariff.

Should you have any questions in relation to this correspondence please contact Michael Bray at michael.bray@aurizon.com.au.

Yours sincerely

Jon Windle
Manager Regulation Network