Friday, 17 April 2015

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4000

By email: aurizon@qca.org.au

RE: UT4 Submission

During September 2014, Springsure Creek Coal Pty Ltd ('Springsure Creek') was placed into Voluntary Administration. Despite this, the Springsure Creek Coal Mine remains a significant resource-based asset, with a potential total peak production output of 7-8 million tonnes per annum of thermal coal.

Springsure Creek therefore continues to remain a strong advocate of the Springsure Creek Coal Mine, and Springsure Creek still considers it prudent to make comment upon a number of aspects contained within a range of submissions from Aurizon Network ('AN') to the Queensland Competition Authority ('QCA').

These submissions include AN’s 2013 ('2013DAU') and 2014 Draft Access Undertakings ('2014DAU'), AN’s 2014 Discussion Paper on the potential short-term transfer mechanism ('2014 Transfer Discussion Paper'), and the 2014 Proposed New Reference Tariff to WICET ('2014 WIRP Pricing Proposal'). In particular, this submission seeks to address four key issues including:

1. Ongoing disincentives in selecting diesel haulage within the Blackwater system;
2. Potential ‘double-dipping’ within the Standard Rail Connection Agreement ('SRCA');
3. Requirements and transfer fees associated with transfer mechanism; and
4. Clarification of incremental costs associated with the Springsure Creek Coal Mine within AN’s 2014 WIRP Pricing Proposal.

**Diesel haul economic disincentive**

At the time of the investment decision regarding the Wiggins Island Rail Project Springsure Creek committed to diesel haulage, due to this being the only option available at the time as the Bauhinia Electrification Project had not been proposed by that stage. As a result, Springsure Creek has deep concerns regarding the economic disincentives associated with diesel haulage within the Blackwater system going forward.

Springsure Creek believes there are two disincentives to undertake diesel haulage, the first revolving around the current capacity multiplier, and the second around the largely unresolved issue of AT5 pricing.
**Diesel capacity multiplier**

Clause 1.3, Part A, Schedule F of the 2010AU details the characteristics of the reference train service, with Clause 5.2, Clause B – Provisions Specific to Reference Train Services in the Central Queensland Coal Region, describing that a reference train can utilise:

...either electric or diesel traction, except that Train Services operating from Rolleston or Minerva will only utilise diesel traction.¹

Within the electrified systems of Blackwater and Goonyella, AN currently applies a capacity multiplier to any diesel service, with that capacity multiplier set at a factor of 1.1. Questions could be raised as to how this multiplier was originally determined – especially if it is the same across two separate systems – as no analytical evidence/report has been provided to stakeholders. But whatever the magnitude, the multiplier is applied to the AT2 base tariff for a system, increasing the base tariff – in this case – by 10% to determine the AT2 diesel tariff.

Section 6.2.2, Part 6 of the 2013DAU proposed to apply a higher capacity multiplier to services not considered to be a reference train, with the 2013DAU drafted to exclude a diesel service from the definition. AN stated that the intention of the multiplier was capacity based and should be applied

...to any service which consumes more network capacity than the reference train. ²

Yet Springsure Creek questions the nature of the capacity multiplier. Specifically, in the case of the Blackwater and Goonyella systems and with continued intense debate about the efficiencies of either traction choice, a potential repercussion of a multiplier could be the incurrence of a cross subsidy from diesel to electric users. Springsure Creek agrees that not all train services are as efficient as one another, such as those that run different lengths of varying axle loads. But until factually based, documented evidence is provided to stakeholders that one traction choice is more efficient, then one particular traction choice should not be considered a reference train.³

Nonetheless Springsure Creek is encouraged to see that AN has recently amended the 2013DAU, excluding the capacity multiplier from within its revised 2014DAU, as well as inserting “...diesel or...” into the Reference Train Service descriptions within Sections 6.1 and 7.1 of Schedule F. Pointedly, as Springsure Creek believes that the capacity multiplier provides a disincentive to diesel users, its supports AN’s changes to the 2014DAU.

**Unresolved issues relating to Blackwater AT5**

Diesel disincentives are not just potentially associated with capacity multipliers. AN’s 2013 Blackwater Electric Traction Price DAAU (‘2013 AT5 DAAU”) proposed that stakeholders who chose to use diesel traction over electric, could be forced to pay an under-utilisation payment (UUP) if electric traction services within the Blackwater system did not meet an average system utilisation of 85%.⁴ Many stakeholders of the Central Queensland Coal Network (CQCN) exhibited stout opposition to the

---

³ This is caveated by system characteristics, i.e., a non-electrified system cannot run electric traction services.
proposed approach. Aurizon, operator of both diesel and electric services across the CQCN, stated that it believed the proposed Blackwater AT5 tariff reflected

...only the efficient costs of providing access to the electric traction infrastructure in Blackwater, including that it should exclude the costs imposed on the system by use of diesel traction. Aurizon further stated that stakeholders who are unable to enact traction choice should be excluded from contributing to any UUP. Specifically [emphasis added]:

\textit{Naturally, users which do not have the opportunity to use electric traction, such as those on non-electrified spurs, should not be required to pay for the option of such a choice.}

Springsure Creek believes there are two key aspects about this statement. Firstly, AT5 tariffs are currently determined by AT5 revenue per system divided by electric Gross Tonne Kilometres (eGTKs) for that same system. It is the belief of Springsure Creek that whilst Aurizon has locked in a number of long-term haulage contracts that utilise electric traction, a number of these contracts still enable the parties to choose diesel traction if they so desire, potentially lowering electric utilisation further. If electric utilisation is lowered, so to would total system eGTKs, increasing the AT5 tariff. In fact, when referencing Aurizon Operations submission to the QCA upon AN’s 2014DAU, since the beginning of 2011 electric utilisation across the Blackwater system has not accounted for more than 65%. This is nowhere near the 85% AN utilised in its AT5 tariff modelling and for this reason, believes a UUP would be more likely. As a result, Springsure Creek believes that both the above and below rail operator seek to lock in parties of existing rail haulage contracts into electric utilisation further strengthening the case for electric traction.

Secondly, the Springsure Creek balloon loop is not planned to be electrified and based upon the above statement by Aurizon, Springsure Creek agrees that it should not be required to pay for any UUP if such a mechanism is revisited in the future, especially if it decides to not electrify its spur.

With the QCA rejecting the 2013 AT5 DAAU in November 2013, many might consider such comments redundant. Yet Springsure Creek believes otherwise. Unambiguously, apart from AN seeking not to be locked into a decision by the QCA which could have potentially seen a higher AT5 price, AN stated that the rationale for withdrawing the 2013 AT5 DAAU was to allow CQCN stakeholders as well as the QCA to focus upon implementing AN’s 2013DAU. Now April 2015, stakeholders still await a Final Decision on pricing related issues, with AN again seeking a further extension of transitional tariffs.

Springsure Creek certainly recognises that competition, efficiency and innovation are all advantages to a system or network that is offered more than one type of traction choice. Yet also Springsure Creek believes that the outcome of the AT5 conundrum has simply been placed into the too-hard basket, relegating the issue further into the future. As the AT5 conundrum potentially impacts upon all stakeholders of the Blackwater system (if not the CQCN) regardless of their traction choice, Springsure Creek remains concerned about AN’s stance and the uncertainty it

\begin{footnotes}
\item [7] ibid, pg. 3
\end{footnotes}
places on stakeholders going forward. Specifically, whilst regulatory certainty is much discussed, Springsure Creek believes commercial certainty is equally important.

**Standard Rail Connection Agreement**

Clause 8.3 of the 2010AU provides for the connection of privately owned infrastructure to the AN owned QQCN.\(^{10}\) Essentially, Clause 8.3 aims to restrict the ability of AN from expanding its monopoly power beyond the boundaries of the currently defined declared service by allowing other parties to connect to the network, whilst also imposing obligations on AN for the connection of privately owned infrastructure.

Though Clause 8.3 is specific in nature, recent years have also seen the development and evolution of the Standard Rail Connection Agreement (SRCA). The SRCA outlines

> ...various rights and obligations of the respective parties to ensure the timely and efficient connection of private infrastructure.\(^{11}\)

In December 2012 the QCA decided to not approve Aurizon Network’s revised SRCA submitted in June 2011, instead advocating its own approach. Aurizon Network subsequently incorporated the QCA’s stance in its revised SRCA as per its 2013DAU. It is noted that industry was generally supportive of the combined AN/QCA SRCA version.\(^{12}\) Owing to the regulatory due process as well as oversight provided by the QCA, Springsure Creek shares this view. However, Springsure Creek seeks to highlight a perceived inefficiency within the wording of the SRCA lodged as part of AN’s 2013DAU, and the subsequent 2014DAU, which ultimately forms AN’s revised UT4 submission.

Upon entering into the SRCA, ownership of connecting infrastructure identified within the SRCA is transferred to AN and included within the Regulated Asset Base (RAB). It is only upon termination or expiry of the SRCA that AN

> ...will do all things to transfer ownership and possession of the Connecting Infrastructure to the Owner (except any part of the Connecting Infrastructure which Aurizon Network reasonably requires for the purpose of continued operation of the Network)\(^{13}\)

In addition, upon acceptance of the SRCA, operational and maintenance obligations associated with the connecting infrastructure are also transferred to AN.\(^{14}\)

The SRCA defines connecting infrastructure as:

> ...the rail infrastructure (including, without limitation, track, signalling and overhead traction electricity (if applicable)) that is either:

> (a) identified as Connecting infrastructure on the plan detailed in Schedule 2); or

---

\(^{10}\) QR Network, 2010, pg. 83


\(^{14}\) Aurizon Network, 2014e, Section 6, Clause 1, pg. 21
(b) not identified on the plan detailed in Schedule 2) as being Private Infrastructure, Connecting Infrastructure or part of the Network, but is managed, controlled or owned by Aurizon Network and connects the Network to the Private Infrastructure.  

In simpler terms, Springsure Creek understands that the Connecting Infrastructure includes as infrastructure up to, and including, the ‘Connection Point’, or the point at which the ‘Private Infrastructure’ meets the ‘Connecting Infrastructure’.

Part 3 of the SRCA outlines that the owner of the connecting infrastructure must pay costs, fees and charges, including:

i. the Annual Service Charge (if any);

ii. the reasonable and prudent costs of the design, construction and commissioning of modifications to, or upgrade or replacement of, the Connecting Infrastructure in accordance with clauses 6(i) and 6(jj), excluding any costs incurred by Aurizon Network in the performance of its maintenance, operation or reinstatement obligations under this Agreement in relation to the Connecting Infrastructure; and

iii. the reasonable and prudent costs of decommissioning and removing the Connecting Infrastructure upon the expiry, or earlier termination in accordance with clause 18, of this Agreement so as to remove the connection between the Network and the Private Infrastructure and restore the affected section of the Network to a condition consistent with the adjacent sections of the Network.

Under the regulatory revenue cap, AN is entitled to earn up to the Maximum Allowable Revenue (MAR) on assets from within the CQCN. Determined via a ‘Building Blocks Approach’, MAR is calculated as (1) Return on assets; (2) Return of assets (also known as depreciation); (3) Operating expenditure attributable to operating the network; (4) Maintenance expenditure on maintaining the network; and (5) Tax.

Outlined within Part 5, s.168(A) of the Queensland Competition Authority Act (‘QCA Act (1997)’), the Pricing Principles state that AN should be able to generate the expected revenue that is at least enough to meet the efficient costs of providing access. Consequently, this would also include the prudent and efficient costs associated with the maintenance and operation of the CQCN, including that associated with connecting infrastructure between the connection point and the mainline. Yet in assessing the wording of the SRCA, it also appears that AN is able to be compensated for costs within the agreement associated in maintaining and operating the connecting infrastructure.

If AN is able to be compensated, not once but twice (once per charging reference tariffs derived by the MAR; and once by maintenance and operating costs as outlined within the SRCA), Springsure Creek queries whether such a mechanism could be an example of ‘double dipping’. If Springsure Creek’s view is accurate, Springsure Creek questions the appropriateness of the duplicated mechanism and approval of the SRCA via reference to Part 5, s.69(E) of the QCA Act, specifically:

The object of this part is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets (s. 69E).

---

15 Aurizon Network, 2014e, pg. 3
16 Aurizon Network, 2014e, pg. 10
Pointedly, Springsure Creek queries how paying for maintenance and operating costs twice is economically efficient, and how such duplicated expense promotes effective competition in upstream and downstream markets, more so given the QCA's Final Position in its Statement of Regulatory Pricing Principles. The August 2013 paper outlined the broad principles used by the QCA which helped guide its decision making powers, with consideration given to risk, regulatory governance and fairness. Yet establishing fairness principle, Springsure Creek notes consideration should also be given to economic efficiency goals. Specifically

The allocation of costs and risks could require considerations of fairness as well as economic efficiency, particularly where there is no clear economic efficiency basis for cost or risk allocation. Where legislation or government directions specify a particular equity or other social goal, the economic efficiency impact will be made transparent where relevant. It is also recognised that fairness will, in some cases, be a pre-requisite for achieving economic efficiency and that procedural fairness and credibility of the regulatory system are important aspects of effective regulation.  

Springsure Creek therefore questions how the ‘fairness principle’ is promoted where a customer is required to pay twice for the same service or product. Consequently, Springsure Creek seeks from the QCA as to whether such a ‘double dipping’ mechanism exists for those stakeholders who have historically entered into a connection agreement.

If a ‘double dipping’ mechanism does exist, Springsure Creek encourages the QCA to remedy the SRCA wording so as to reflect the true meaning of s.69(E), so as to not ‘double penalise’ the ‘Owner’ as defined within the SRCA.

Short-term transfer mechanism

In December 2014, AN submitted a discussion paper on a potential short-term transfer mechanism ('2014 Transfer Discussion Paper'), where Springsure Creek understands that the QCA will soon make a decision in relation to short-term transfer mechanism and associated transfer fees.

The capacity trading concept principally allows the transfer of existing access rights, or capacity, from one party to another.

Springsure Creek believes the ability for coal providers to utilise trading within the CQCN will: improve operational flexibility; increase, or at the very least maintain, system throughput; maintaining – if not increasing – the economic, allocative and productive efficiency of the coal export supply chain across the short, medium and long-term.

In circumstances where additional access rights are required, AN states that [emphasis added]

This type of short term transfer will require an assessment of available capacity in order to determine whether the additional access rights can be granted on a short term basis to give the complete train paths needed by the transferee. However, Aurizon Network will have only a relatively limited window of opportunity to assess capacity availability and determine whether those additional access rights can actually be granted, as such it is anticipated, to the extent reasonably practical, that available capacity for this type of transfer will be pre-determined.  

---

19 AN, 2014b, pg. 7
As per the 2014 Transfer Discussion Paper, Springsure Creek recognises that AN has been implementing new technology to assist with the ability to effectively undertake the short-term transfer mechanism. In this light, Springsure Creek seeks clarity on a number of aspects, being:

1. What capabilities the new technology will provide?
2. When would the technology be operationally ready?
3. Would this technology assist in enlarging the ‘relatively limited window of opportunity’ for the granting of access rights?
4. Could AN please provide confirmation that it is seeking to include the costs of the new technology within the RAB?

**Short-term transfer requirements**

The 2014 Transfer Discussion Paper outlines a number of requirements to apply to short-term transfers, including a maximum limit of Train Service Entitlement’s (TSE’s), a common destination and [emphasis added]:

> ...the short term transfer will only be permissible where the transferee’s train services will have access charges based on the *same reference tariff* as that used in respect of access charges for the transferor’s train services that are the subject of the short term transfer.*

However Springsure Creek remains concerned about this requirement, specifically in relation to the outstanding decision upon the Wiggins Island Rail Project (“WIRP”). For instance, the QCA is yet to decide if expenditure associated with the WIRP will be socialised. If no socialisation where to occur, it would be doubtful that reference tariffs of a stand-alone WIRP system would be equal to that of the existing Blackwater system.

As a result, based upon the above requirement, users within the WIRP system would be unable to utilise a short-term transfer mechanism with non-WIRP users in the Blackwater system, even though all users rail to Gladstone region. Springsure Creek understands that the implication of different reference tariffs would create complexities in managing the short-term transfer mechanism. Yet Springsure Creek also believes if the QCA where to determine a WIRP pricing proposal of non-socialisation, WIRP users (in particular) would be disadvantaged even further by not being able to utilise the short-term transfer mechanism.

Further, in relation to the Gladstone region, Springsure Creek also questions the potential restrictive nature of the term ‘common destination’, particularly from the aspect of WIRP users. For instance, WICET is located approximately 1km from the existing terminal destinations of RG Tanna (“RGT”), Barney Point Terminal (“BPT”) and Port of Gladstone (“PG”). With AN proposing to limit the ability of users to utilise short-term transfers that only share a common destination, Springsure Creek questions whether such restrictions are rationale when ports are located so close to one another.

**Transfer fees**

Currently an access holder can transfer train paths to another access holder as long as a transfer fee is paid, where that fee is deliberately intended to protect AN from any loss in revenue associated with reassigning train paths.

---

20 AN, 2014b, pg. 9
Whilst AN provides an example how relinquishment fees are calculated, there seems to be no similar example of how transfer fees are calculated. For completeness, Springsure Creek believes it can provide transparency into this area.

The transfer fee is determined by two parts. The first part involves calculating the Present Value (PV) of the Total Take-or-Pay (ToP) revenue for the Transferor. The second part then adjusts the PV of the Total ToP by both a Reduction factor and Common Contribution to Cost (CCC) factor. Once both parts have been determined, the second part of the equation is deducted from the first. This can be represented as follows:

$$\text{PV ToP} - \text{PV ToP} \times [\text{Reduction factor} \times \text{CCC factor}]$$

By way of example, assume two mines are located in the same system and each output 1 million tonnes per annum (Mtpa). Mine A (the ‘Transferor’) is seeking to transfer 250 train paths (TP) to Mine B (the ‘Transferee’). Mine A is 100km from the destination, where Mine B is located further away, some 250km. Both mines share a common rail corridor of 150km.

<table>
<thead>
<tr>
<th>Mine</th>
<th>Distance (km)</th>
<th>Train paths (TP)</th>
<th>AT2</th>
<th>AT3</th>
<th>AT4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mine A</td>
<td>100</td>
<td>250</td>
<td>$1,200</td>
<td>$5.00</td>
<td>$1.00</td>
</tr>
<tr>
<td>Mine B</td>
<td>250</td>
<td>250</td>
<td>$1,200</td>
<td>$3.00</td>
<td>$1.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mine</th>
<th>Tonnes pa</th>
<th>MTK</th>
<th>AT2</th>
<th>AT3</th>
<th>AT4</th>
<th>Total ToP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mine A</td>
<td>1,000,000</td>
<td>100,000</td>
<td>300,000</td>
<td>500,000</td>
<td>1,000,000</td>
<td>1,800,000</td>
</tr>
<tr>
<td>Mine B</td>
<td>1,000,000</td>
<td>250,000</td>
<td>300,000</td>
<td>750,000</td>
<td>1,000,000</td>
<td>2,050,000</td>
</tr>
</tbody>
</table>

The Total ToP for Mine A is the sum of revenue across AT2, AT3 and AT4. As Mine A is seeking to transfer paths in one financial year, Total ToP equals the PV ToP.

The Reduction factor is calculated as:

- Common corridor distance divided by distance of shortest haul (i.e. Mine A)  
  = 150km / 100km  
  = 1.50

And the CCC factor is calculated as:

$$\frac{\text{CCC}_{\text{Mine } A}}{\text{CCC}_{\text{Mine } B}} = \frac{(\text{Total ToP}_{\text{Mine } A} / \text{Total kilometres}_{\text{Mine } A})}{(\text{Total ToP}_{\text{Mine } B} / \text{Total kilometres}_{\text{Mine } B})} = \frac{(2,050,000 / \text{Distance}_{\text{Mine } B} \times \text{Train paths}_{\text{Mine } B})}{(1,800,000 / \text{Distance}_{\text{Mine } A} \times \text{Train Paths}_{\text{Mine } A})} = \frac{(2,050,000 / 250 \times 250 \text{ TP})}{(1,800,000 / 100kms \times 250 \text{ TP})} = \frac{(2,050,000 / 62,500)}{(1,800,000 / 25,000)} = \frac{32.80}{72.00} = 0.456$$


22 PV of Total ToP = Total ToP as transfer is within the same financial year. If across more than one year, second year would need to be discounted. Total ToP equals the sum of AT2, AT3 and AT4.
Finally with all elements determined, the Transfer fee can be calculated as follows:

\[
= PV \text{ ToP} - PV \text{ ToP} \times [\text{Reduction factor} \times \text{CCC factor}]
= 1,800,000 - 1,800,000 \times 1.50 \times 0.456
= 570,000
\]

Therefore, in this instance Mine B would be liable to pay a transfer fee of $570,000.

Yet the origins of transfer fees stem back to UT1, where AN (then Queensland Rail) operated under a price cap framework. As UT1 evolved into UT2, a revenue cap framework was initialised where since that time, AN has remained:

...substantially protected from revenue short fall that arises through the transfer of access rights by way of the revenue cap.\(^23\)

Whereas Springsure Creek recognises the willingness of AN to improve the efficiency of the CQCN by taking the initiative to remove the somewhat archaic, and even redundant, mechanisms of transfer fees, such fees are only currently associated with access agreements under UT1 and UT2, or UT3 access agreements with tenures longer than two years. With stakeholders approaching the half way mark of UT4, it is reasonable to conclude that only a handful of UT1 and UT2 access agreements may remain in effect. Yet even if a substantial number of agreements where still in place, the protectionist nature of the revenue cap mechanism questions the practicality of the transfer fee mechanism altogether. As a result, Springsure Creek believes that the relevancy of transfer fees has substantially diminished and strongly supports the concept, and applicability, of transfer fees to be abolished.

**WIRP pricing proposal**

AN’s 2014 WIRP Pricing Proposal\(^24\) seeks approval from the QCA for new transitional tariffs within the Blackwater and Moura systems, taking into account additional revenue and volumes associated with the Wiggins Island Rail Project (WIRP).

Section 3 of the 2014 WIRP Pricing Proposal highlights that in recognition of Clause 4.1.2, Schedule F of the 2010AU, new private incremental costs, incremental costs and the required minimum contribution to common costs are all considered in determining charges that are incremental to WIRP train services operating within the Blackwater and Moura systems.

Whilst AN states it has been advised of private incremental costs by Cockatoo Coal for its Baralaba Coal Mine, no mention is made of similar costs attributable to the Springsure Creek Coal Mine. If incremental costs of the mine specific infrastructure for Springsure Creek have not been properly accounted for then such an omission could impact key pricing parameters, and ultimately affect the access charges payable.

Springsure Creek therefore seeks clarification on this issue and requests AN to indicate whether such costs have been excluded. If confirmation is provided, Springsure Creek believes that this would be a simple oversight as any incremental cost borne by the producer should be included in determining applicable reference tariffs.


If you have any questions regarding this submission, please contact myself or Mr Jamie Freeman (jfreeman@balanceadvisory.com).

Yours sincerely

Matthew Scott
Chief Financial Officer
Springsure Creek Coal Pty Ltd (Administrators Appointed)

T:  (07) 3041 4409
M:  0409 496 625
E:  matthewscott@bandannaenergy.com.au