QRC

# submission

Working together for a shared future

**QRC submission to the QCA**

**GAPE DAAU**

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ABN 59 050 486 952
Level 13 133 Mary St Brisbane Queensland 4000
T **07 3295 9560** F 07 3295 9570 E info@qrc.org.au

**www.qrc.org.au**

# 1. Background

On 5 September 2012, QR Network ("QRN") submitted a DAAU to the QCA to establish a reference tariff which will apply to rail infrastructure connecting North Goonyella to Newlands (the Northern Missing Link) and to certain infrastructure which is physically located within the Goonyella or Newlands systems. QRN proposes that this infrastructure be treated as a new system within the Central Queensland Coal Network, rather than as part of the Goonyella or Newlands systems.

QRC welcomes this opportunity to provide comments on the DAAU. It is noted that QRC members may also provide submissions on the DAAU on an individual basis.

QRC confirms that this submission may be made publically available.

# 2. Summary

- **Transparency:** QRC is constrained in its ability to fully assess the implications of the DAAU due to (i) the lack of visibility of the commercial agreements entered into in respect of this project (ii) insufficient information in regard to the key assumptions which lead to the development of reference tariffs and (iii) insufficient transparency regarding the development of reference tariffs using these assumptions. QRC encourages QCA to seek this additional information and encourages a more transparent approach to these matters in finalising the GAPE DAAU process and in future regulatory processes.

- **The GAPE System:** QRN's proposal to establish the GAPE assets as a new system within the Central Queensland coal region for the purposes of pricing (rather than to include these assets within existing systems) appears a reasonable approach to achieving certain pricing outcomes.

- **Pricing proposals and 'socialisation':** QRN's proposal reflects a range of different approaches to pricing and socialisation of costs. Some of these approaches differ from approaches which have been taken in the past, however in most cases, QRN's proposals are consistent with QRC's preferred approaches to pricing and socialisation as submitted to the QCA in March of 2011. QRC:

    - supports QRN's proposed approach to cost allocation and pricing in respect of (i) rail enhancement costs incurred in Goonyella system for GAPE customers (ii) electrification of additional passing loops in Goonyella (iii) costs incurred in the Newlands system for GAPE customers.

    - supports, subject to additional information and QCA review, QRN's proposed approach for costs incurred in Newlands system for NAPE customers and in regard to costs previously included in the Newlands capital indicator.

    - has strong concerns regarding the equity of QRN's proposal in regard to pricing of additional services using the NML (beyond those contracted by foundation customers).

- **Tariffs:**

    - QRC supports QRN's proposal to defer certain revenue rather than charging a 'full cost recovery' tariff at a time when the newly commissioned asset is not fully utilised.

- QRC has strong concerns regarding the claimed maintenance and operating cost allowances. The amounts claimed by QRN in relation to opex and maintenance appear high for a greenfield railway operating in its early years at low volumes.

- QRC considers that a Capacity Review should be undertaken under Section 11.1.4 of the undertaking upon the creation of a new Individual Coal System, particularly given the likely effects which this has on Coal Chain Operating Assumptions.

- **Amendments to the Undertaking:** We have a number of suggested changes, and questions, regarding QRN's proposed amendments to the undertaking. QRN's proposal regarding equity raising costs raises a number of complex issues and is interlinked with other issues including the development of the WACC. We consider that this issue should be considered in the development of UT4.

# 3. The GAPE System

The proposed GAPE System would be comprised of certain infrastructure which is physically located in the Goonyella system and the Newlands System, plus the Northern Missing Link ("NML"). This differs to existing systems within the Central Queensland coal region, which generally comprise infrastructure which connects a group of loading facilities to certain unloading facilities, with limited infrastructure being shared between systems. The creation of a GAPE system also necessitates the allocation of maintenance and operating costs which are incurred within the Goonyella and Newlands systems between those systems and GAPE.

Alternatives to QRN's proposed approach would include allocating the NML to either the Goonyella or Newlands system, treating paths which originate in the Goonyella system as cross-system traffic, and applying system premiums where necessary to achieve desired pricing outcomes.

The QRC considers that treating the GAPE assets as a new system is a practical approach and is likely to be less complex than any alternative method of achieving the desired pricing outcomes.

# 4. Pricing proposals and 'socialisation'

The GAPE DAAU reflects certain proposed approaches to pricing and to the socialisation of costs. The approaches proposed exhibit varying degrees of consistency with past practice and with the existing access undertaking. We note however that:

- as QRN's proposal is a DAAU (ie. a proposal to amend the undertaking), consistency with the existing undertaking is not a requirement; and

- QRC's preferred approach to pricing and socialisation is not reflected in the current undertaking. QRC has previously proposed certain changes to the access undertaking dealing with the socialisation of costs. Extracts of the QRC's 18 March 2011 submission to the QCA (which was in response to certain 'socialisation' issues which arose under QRN's first proposed Investment Framework/User Funding DAAU), are attached. Part 9.5 of the attachment provides QRC's position on pricing and socialisation, which in summary is:

  i. If the cost of an expansion (taking into account the cost of all capex, whether mainline or otherwise) would increase reference tariffs in an existing system, then a new reference tariff (or system premium) should apply to the expansion, such that existing tariffs are not increased. In this case, a zero contribution to common costs is acceptable.

ii. Where an expansion has a lower cost than any previous expansion using comparable segments of infrastructure, the cost should be averaged with the most expensive prior project (i.e. averaging down).

iii. Where an expansion delivers clear benefits to existing users, an allocation of project costs to those users (through reference tariffs) may be appropriate.

QRN's approach to pricing in the GAPE DAAU needs to be considered in respect of Goonyella enhancements, Newlands enhancements undertaken for NML users, Newlands enhancements undertaken for NAPE deed customers, and Newlands enhancements which were included in the capital indicator. In most cases, QRN's proposed approach appears consistent with the QRC's proposed pricing principles set out above.

The approach proposed by QRN within each system, and our views in regard to each approach, is set out below. Note that QRC's comments below relate to the principles which we understand have been applied, based on the explanation provided by QRN in its submission. We are not in a position to comment specifically on whether these principles have been properly and consistently implemented, for example, in the allocation of capital costs to systems. As noted above, the modelling used by QRN, including allocators and other variables and assumptions, should be made available to stakeholders to test that the allocation methodology has been properly and consistently applied.

- **Goonyella: Rail enhancements**

  QRN proposes that capex and opex incurred due to GAPE in the Goonyella system is allocated to the GAPE system. This means that the expanding customers (ie. GAPE customers) effectively pay the full incremental cost of the expansion (including capital and operating costs), such that the tariffs of Goonyella users do not change. GAPE customers do not pay a contribution to common costs in the Goonyella system.

  QRC view: QRN's proposed approach is consistent with the QRC's preferred approach to pricing, particularly items (i) and (ii) above. QRC therefore supports QRN's approach in regard to costs incurred in the Goonyella system.

- **Goonyella: Electrification works**

  QRN proposes that the cost of electrification of passing loops constructed in the Goonyella system, but triggered by the GAPE project, be allocated to the GAPE system.

  QRC view: This proposal is unusual in that electrification costs will be allocated to diesel train services. In the current case however, QRC considers that QRN's approach is cost reflective, in that costs which were triggered by the provision of capacity for these diesel services are to be allocated to those services. The approach is also consistent with QRC's pricing principle item (i) (ie. existing users to be no worse off). QRC therefore generally supports QRN's proposal. We note however that it may have been possible to achieve a similar outcome by allocating the new electric assets to the Goonyella system and requiring that GAPE users make a common cost contribution to the Goonyella system (equal to the costs triggered by the electrification of these passing loops). QRC suggests that QCA considers the relative merits of these alternative approaches.

- **Newlands: Costs incurred for GAPE customers**

  Costs deemed to be incurred for GAPE customers within the Newlands system are allocated to the GAPE system. The treatment is therefore consistent with the Goonyella approach (expanding customers are paying the full incremental cost, but no contribution to common cost).

  QRC view: Support QRN's proposed approach.

- **Newlands: Costs incurred for NAPE customers**

  QRN proposes that costs deemed to be incurred for NAPE customers (ie. customers which gained contracted capacity from this project, whose load point is in the Newlands system) are added to the Newlands system. This has no impact on Newlands tariffs under UT3, as these costs are being deferred until UT4. The impact of this approach under UT4 is unknown. The additional costs allocated to the Newlands system will be offset to some extent by additional volumes, with the net result being an increase or decrease in tariffs. If the net result involves little or no change in tariffs, then the treatment is broadly consistent with the treatment of costs incurred in Goonyella and Newlands for GAPE customers (ie. expanding customers are paying incremental costs and no contribution to common costs). If the result is lower tariffs, then this is consistent with past practices (new customers must at least pay the new average tariff), while if tariffs are increased by the inclusion of these project costs and volumes, there may be a case for a system premium to be applied.

  QRC view: QRC generally supports QRN's proposed approach subject to the impact on Newlands tariffs in UT4 being a reduction in tariffs. QRC suggests that the QCA should obtain the required data and model the effect of QRN's approach on future tariffs to confirm that a System Premium is not required.

- **Newlands: Costs previously included in capital indicator**

  Certain capital costs are allocated to Newlands system on the basis that costs of a similar value would have been incurred in this system even in the absence of the GAPE project (for track renewal works). If this is the case, then this allocation will have no adverse effect on Newlands system tariffs.

  QRC view: QRN's proposed approach may be consistent with item (iii) of QRC's preferred approach to pricing (ie. the cost allocation reflects a benefit to existing customers). Although the allocated amount was previously included in a capital indicator, we rely on the QCA to assess whether the allocated cost ($40m) would have been incurred in the absence of the GAPE project. If this was reviewed by the QCA during the UT3 approval process, or is confirmed during the QCA's current assessment, then QRC supports QRN's proposed approach. We also suggest that an improved CRIMP process could provide a more transparent and robust basis on which the capital indicator could be developed.

- **GAPE: future expansions**

  Within the GAPE system, QRN proposes that new services which use the NML (beyond the foundation customers) will pay all incremental costs (private or mainline) plus the GAPE Reference Tariff. This appears to provide a potentially very large contribution to common costs (ie. equal to the full GAPE tariff).

  QRC view: The proposed approach is not consistent with past practices, with the existing undertaking, with the approaches being proposed in respect of the Goonyella or Newlands systems, or with QRC's preferred approach to pricing (because the tariff of the expanding producer will be higher than the reference tariff of existing producers and will include a potentially large contribution to common costs). QRN justifies this approach on the basis that *"the commercial arrangements which underpin the development of the GAPE project are based on a uniform price of use by all users (ie.an equal share of the project costs)."* We assume that this statement refers to an equal share of initial project costs, as the approach proposed by QRN will not result in an equal sharing of total project costs (including the expansion costs). QRC considers that the QCA should assess the equity of this proposal on its merits. Future users of GAPE expansions may not have been parties to the 'commercial arrangements', and these arrangements were not reviewed or approved by the QCA. The result of the proposal will be that new users pay a higher reference tariff than initial users for accessing the NML, even if a socialisation of the expansion cost would have resulted in lower tariffs for the initial users.

Disclaimer/note on QRC view: The QRC's views are based on consideration of reference tariff effects only. To the extent that GAPE foundation customers incur additional costs under the commercial agreements and similar costs are not incurred by expanding customers (or are not of the same magnitude because of a lower unit cost of additional capacity), then this may well have implications for the 'equity' of QRN's proposal. That is, while later users will be paying a higher reference tariff than foundation customers under QRN's proposal, they will not necessarily be paying more overall (when additional charges under commercial agreements of foundation customers are considered). QRC is not in a position to consider this matter. It is not possible to consider the merits of the pricing proposal given the lack of transparency of the commercial agreements. For the future, QRC considers that any special terms sought by QRN should be in the form of Access Conditions under Section 6.5.2 of the Access Undertaking, and that the merits of imposing Access Conditions on a 'subsequent party' for the benefit of the 'first party' should then be assessed.

# 5. Tariffs

QRC does not have access to the information required (including models) to assess the development of the proposed reference tariffs, nor the values of inputs such as volumes, capital costs, maintenance costs and operating costs, and relies on the QCA's assessment of these matters. Our comments on the approach described in QRN's submission are:

- **WACC:** QRN proposes to apply the cost of capital determined by the QCA under the 2010 Undertaking (9.96%). QRN comments that the asset stranding profile differs significantly from existing systems and comments (P14) "*there will be a need to develop appropriate principles to ensure current pricing and risk allocations reflect the consequences of these scenarios*". We do not understand the intention of this statement. QRC considers that any assessment of risk differentials for GAPE must take into account risk mitigation achieved by QRN under the commercial agreements, and indeed QRC would expect that this would be the appropriate place for such risks, if any, to be addressed. This is a further example of why Access Conditions are a more appropriate and transparent means of dealing with arrangements involving a rate of return or other tariff arrangements other than those contemplated under the existing framework.
- **Depreciation:** QRC supports QRN's proposal to defer depreciation during the 'ramp-up' period. Charging a 'full cost recovery' tariff at a time when a newly commissioned asset is not fully utilised may have adverse effects on customers and on the utilisation of the asset. Provision of a reference tariff model including the ramp-up profile would assist customers to understand the immediate and longer term effect on tariffs of this proposal and changes in volumes over time.

- **Volumes:** A number of QRC members have advised that the volume forecasts adopted by QRN for GAPE appear high and are unlikely to be achieved. This may lead to an overestimation of maintenance costs. Also, if the QCA's review indicates that the likely volumes are significantly lower than those used in the DAAU, then there may be a case for the deferral of capital charges on GAPE, as QRN has proposed for Newlands.
- **Capacity:** QRC considers that a Capacity Review should be undertaken under Section 11.1.4 of the undertaking upon the creation of a new Individual Coal System, particularly given the likely effects which this has on Coal Chain Operating Assumptions. QRC members are keen to understand the capacity which has been created in the GAPE System and any impacts which may have occurred in terms of the capacity of the Goonyella and Newlands Systems.
- **Maintenance, Opex and Risk Premium:** QRC considers that, with the remaining term of UT3 being extremely limited, it is appropriate to assess the maintenance, opex and risk premium (which we understand to be insurance) requirements for this period based purely on the incremental costs which will be incurred over this short period (which features very low volumes of additional train services), rather than by extrapolation of long run average costs of other, older systems. Based on the very limited supporting information provided, it is not clear to us whether this is the approach that QRN has adopted, and we generally rely on the QCA to carefully assess this matter based on further information from QRN. As a general observation, a number of the "bottom up" costs claimed for opex and maintenance appear high, particularly for a greenfield railway (for which costs would be expected to be substantially lower than for older railways). For example, substantial expenditure appear to be forecast in relation to activities such as ballast cleaning, rail grinding and track resurfacing, which should not be required in relation to new rail infrastructure. QRN should also be required to provide access to its 'Network Strategic Asset Planning' tool and all relevant inputs, to enable this modelling to be validated.
- **GAPE related Newlands capex:** QRC supports QRN's proposal to defer costs associated with GAPE related Newlands capex until UT4 to align with the tonnage ramp-up profile and to avoid adverse tariff impacts on existing customers.

# 6. Amendments to the undertaking

Without limiting the QRC's comments above, the QRC makes the following comments about the drafting changes to the access undertaking:

- **Clause 8.3(f)**: The changes to this clause do not appear to have any relevance to the GAPE project or the tariff. The changes do appear relevant to the connection agreement. The QRC understands that the DAAU need not be limited to matters relating to GAPE, and we do not have any objection to the changes. However we do consider that the operating and maintenance costs of connections should generally be included in QRN's costs for the purposes of developing reference tariffs, rather than being directly recovered from the owner of private infrastructure. This provides a more transparent approach and reflects the reality that these costs will be difficult to separate or distinguish from the mainline operating and maintenance costs.
- **Definition of Goonyella to Abbot Point System**: As drafted this definition includes components of the Goonyella and Newlands systems that existed prior to the completion of the GAPE project (which we understand are intended to be considered part of the Goonyella and Newlands systems). The definition would also overlap with the definition of Goonyella System and Newlands System. The QRC queries whether this definition should only include those components of the Goonyella system and Newlands systems that were upgraded as a part of the GAPE project.

- **Clause 9.1(m)**: The Northern Missing Link should be deemed to be a part of the Newlands System for all of clause 9.1, and not just for clauses 9.1(d) to (h) and (j). However, reporting the NML separately in the case of 9.1(i) is useful.
- **Clause 9.2.3(d):** QRC does not support the inclusion of the NML in the Newlands system for the purposes of maintenance reporting. As a new asset, the maintenance requirements of the NML will differ substantially from the requirements of the Newlands system, and information on the NML requirements is important for a number of purposes including the development of future GAPE reference tariffs.
- **Item 4(f) of Schedule A**: The proposal regarding equity raising costs raises a number of complex issues (such as the assumption of a 0% dividend reinvestment) and is interlinked with other issues including the development of the WACC. We consider that this issue should be considered in the development of UT4.

# 7. Transparency

QRC has been constrained in its ability to fully assess the implications of the DAAU due to a lack of transparency in regard to the commercial agreements (GAPE and NAPE deeds), insufficiency of information regarding the assumptions used to develop reference tariffs, and the lack of a transparent model which translates assumptions into reference tariffs.

### 3.1 GAPE and NAPE deeds

QRN's rationale for a number of proposals contained in the GAPE DAAU is that the proposed treatment is required under these deeds. The allocation of costs is said to be "*designed to integrate into those commercial arrangements*" (DAAU Section 1). Certain capital costs incurred on the NML will be allocated to Newlands system "*in order to give proper effect to the commercial arrangements underpinning the GAPE project*" (DAAU Section 6.4). Other capital costs are allocated to systems based on the relative tonnes contracted under NAPE and GAPE deeds (DAAU Section 6.4.1). The proposal to amend the undertaking so that new services which use the NML are charged the published reference tariff plus all incremental costs is explained on the basis that the deeds are based on "*a uniform price of use by all users (ie. an equal share of project costs)*" (DAAU Section 10.4).

QRC has found it extremely difficult to consider the implications of the DAAU or the merits of QRN's proposed approaches without having some understanding of the content and effects of the deeds. At a minimum, we consider that QCA should obtain access to the deeds so that the QCA can consider the extent to which the deeds are relevant to the proposed approaches (particularly where the deeds are provided as part of the rationale by QRN) and whether other elements of the deeds have implications for the DAAU which are not apparent from the publically available information.

We also note QRN's claim that the "*asset stranding profile for the GAPE Reference Tariff differs significantly*" from other systems and that "*there will be a need to develop appropriate principles to ensure current pricing and risk allocations reflect the consequences of these scenarios*" (DAAU Section 6.1.1). We consider that the terms of the deeds will be an important factor for the QCA's consideration of 'appropriate principles' if these are proposed by QRN in the future.

For the future, we would hope that access conditions will be sought only through processes which involve QCA review and approval. Where this occurs, there is a strong argument for access conditions to be imposed on later users of the relevant asset to ensure equity between foundation customers and later users. In the current case, questions of equity between foundation customers and later users can only be assessed if QCA obtains access to the deeds.

**3.2 Development of reference tariffs**

The DAAU provides information regarding the assumptions (capex, opex and volumes) which are used to derive reference tariffs but not a model through which customers can gain an understanding of how these assumptions are translated into reference tariffs. QRC considers that such a model should be made available not only for GAPE but in all cases where new or amended reference tariffs are developed. This occurs in a range of other regulated industries and assists customers to understand matters such as the impact of capital expenditure and volume variations. Given that the relevant assumptions are provided in public documents, we do not consider that a model showing these assumptions should be considered confidential.

**3.3 Consultation**

QRC considers that a number of the issues raised in this submission could have been dealt with through consultation prior to submission of the DAAU. The approach of commencing consultation through the formal lodgement of documents with the QCA, or providing only a high level overview prior to lodgement, is not an efficient means of resolving regulatory issues. QRC continues to encourage QRN to engage in meaningful consultation prior to submitting DAAU's or other formal documents with the QCA. This provides an opportunity for QRN to reflect customer feedback to the extent it is willing, or alternatively provides customers with a better understanding of the rationale for the positions taken by QRN. The current situation, in which none of the deferred UT3 processes have progressed beyond a draft decision (and those draft decisions are to reject) and other processes such as the electric traction DAAU have been strongly opposed by industry, is not acceptable. Clearly all parties need to consider how this situation can be changed.

# Attachment: Extract from 18 March 2011 QRC submission to QCA



## 9. Pricing matters

### 9.1 Overview

QR Network has submitted a proposal within the 2011 DAAU which is a significant departure from current Undertaking provisions regarding pricing (refer to 6.4.2(a)(iii) of the 2011 DAAU). This proposal by QR Network was in response to concerns raised by a number of coal producers. Industry has since developed a preferred approach to address industry concerns, which differs from the solution proposed by QR Network. This section provides QRC views of the QR Network proposal and outlines the preferred industry approach to pricing matters.

The establishment of new reference tariffs and the varying of existing reference tariffs have always been important matters for industry. More recently industry has become keenly interested in the establishment of new, clearer principles for setting tariffs, due to:

- The expected large, lumpy incremental costs associated of the next round of track enhancements.
- Concerns that the current undertaking provisions can lead to inefficient and inequitable outcomes.
- A requirement to have a higher degree of certainty (early in the life of a project) regarding the approach being taken to pricing, due to the need to:
    - Complete mine feasibility studies (of which rail costs are a significant input) prior to making binding commitments to rail and port projects;
    - Ensure that pricing approaches are consistent between User-Funded and QR Network funded projects; and
    - Determine which existing mines (if any) will have their tariffs affected by an expansion project for the purpose of determining Reference Tonnes for Master Plan voting processes.

### 9.2 The existing (2010 Access Undertaking) rules

QRC's understanding of the 2010 AU pricing provisions is that, when a new reference tariff is established, that tariff must be sufficient to cover the incremental costs of the relevant project and provide a minimum common cost contribution. Incremental costs include the additional costs of providing access (including all capital extension/expansion costs) on any spur lines or existing mainline compared to the costs which would be incurred if the service did not operate. Therefore, when a new reference tariff is established, the result for existing Users of a system would be a reduction in tariffs (due to the minimum contribution to common costs).

However, this does not mean that the current rules will always result in expansion projects lowering costs for existing users, because:

- When an existing train service expands, there is no trigger for establishing a new reference tariff. Therefore the project costs are 'socialised' within the relevant system. In this case there may be no contribution to common costs, and incremental costs may not be fully covered.

Attachment: Extract from 18 March 2011 QRC submission to QCA (cont)



- For new train services, it is not clear whether the requirement to cover all incremental costs plus a common cost contribution is strictly applied. Part 2 of QR Network's January 2011 Explanatory Notes seems to indicate that incremental mainline capital expenditure costs are incorrectly treated within the minimum contribution common costs, such that the average system price for existing Users may be increased by an expansion project.

**9.3 QR Network's proposed amendment**

QRC recognises that QR Network's proposal has been developed in response to industry concerns. The proposal suggests a trigger threshold under which a new reference tariff will be developed if the inclusion in the RAB of a Significant Investment would increase the Reference Tariff by more than 20%. As drafted, this amendment would apply only to new Reference Train Services, although this may not be QR Network's intention.

QRC does not support QR Network's proposed amendment, however, industry recognises that the intention was to respond to industry concerns and QRC welcomes the recognition that this complex issue should be addressed.

**9.4 Key concerns with current provisions:**

*A lack of pricing certainty*
Under current arrangements the tariff pricing outcome may be finalised just prior to, or even after, commissioning of an expansion. However, Users need to make binding investment and contractual commitments well ahead of these timeframes. Industry appreciates that approved tariffs are subject to the finalisation of the total cost and therefore some degree of uncertainty will remain until a project is completed. However, the approach to pricing (socialisation, incremental or some form of hybrid) should be clear well before commitments to a project are required. Recent examples highlight the issue:

- The pricing approach for GAPE has not yet been established, although:
  - A number of existing mines which will not be users of GAPE have been asked to vote on this project in the Master Planning Endorsement process, yet are unaware of how their tariff will be affected.
  - Producers were required to enter into underwriting agreements which provided a price structure irrespective of the QCA's approved reference tariff.
- WICET Stage 1 producers are currently considering billion dollar infrastructure investments (rail, port and mine) and have already made significant commitments, all in the absence of certainty as to the ultimate rail pricing approach.

*Incentives for Expanding and non-expanding Users*
The approach used to determine tariffs has implications on the incentives of Users in regard to Significant Investments. For example, when the incremental costs associated with a rail expansion are above the system tariff:

Attachment: Extract from 18 March 2011 QRC submission to QCA (cont)



- Socialisation may encourage existing Users to challenge the underlying need for the project (such as through Master Planning endorsement processes) or to challenge negotiated Access Conditions, both on the basis of possible future impacts on their tariff.
- Socialisation does not provide an appropriate price signal for expansions. This could promote expansions which would not be viable on an incremental cost basis.

On the other hand, incorporating a common cost contribution plus all incremental rail expansion costs results in non-expanding producers receiving a lower tariff and in expanding producers facing an additional cost in what may already be a high-cost project. This could represent an effective cross subsidy in the event that there is no surplus capacity in the existing system.

*Current arrangements are inequitable (expanding mines are favoured over new mines)*
The cost of expansions accommodating existing load-outs using existing unloading facilities (existing Train Services) are socialised, while a new service must make at least a minimum common cost contribution to the existing system and pay the incremental costs relating to the service.

The current pricing arrangements were developed in an environment where spare capacity existed or additional capacity could be created at a relatively low incremental cost. The arrangements are not suitable in the current environment, where spare capacity does not exist and expansions have a high incremental cost.

**9.5 QRC Position**

QRC's proposes the following arrangements:

- QR Network should submit a proposed reference tariff if the inclusion into the RAB of the cost of an expansion project would otherwise increase the reference tariffs for that individual coal system. This should apply regardless if the expansion is to accommodate new or existing train services. The new reference tariff for the expansion project should be sufficient to cover the full incremental (including mainline) costs of the expansion.
- In cases where an expansion project has a lower cost than any previous expansion using comparable segments of rail infrastructure, the costs of the expansion should be averaged against the most expensive prior expansion (ie. the cost of the prior expansion is averaged down).
- In a case where an expansion project delivers a clear and measurable benefit to existing users, QR Network should propose (for QCA approval) an allocation of project costs between existing and expanding Users for the purpose of developing reference tariffs. Note however that QRC does not accept that an expansion will necessarily reduce congestion: this will depend on the relative capacity created and contracted.

QRC's approach has the key desirable features:

- Provides consistent rules for New Train Services and expanding existing Train Services.
- Delivers a zero contribution to common costs for expansions that have high incremental costs, rather than requiring a contribution which further increases costs as applies in the current rules.

Attachment: Extract from 18 March 2011 QRC submission to QCA (cont).



- Non-expanding producers are no worse off because of an expansion project and therefore have no incentive to oppose expansion projects.
- Provides considerable pricing certainty for expanding and non-expanding producers.
- Enables producers who participate in 'high cost' expansions to obtain benefits from subsequent lower cost expansions.

QRC understands that the above approach generates different tariffs for a number of major expansion phases. In terms of administrative complexity, QRC considers that the current undertaking rules already require reviews of all Incremental Costs for new Train Services and applying this to the expansion needs of existing services would not be unreasonable. Therefore, the key additional task involves tracking investments over future expansion stages when determining the relevant expansion tariff.

QRC considers that the above pricing arrangements would provide greater certainty and result in a fair allocation of expansion costs for all Users.