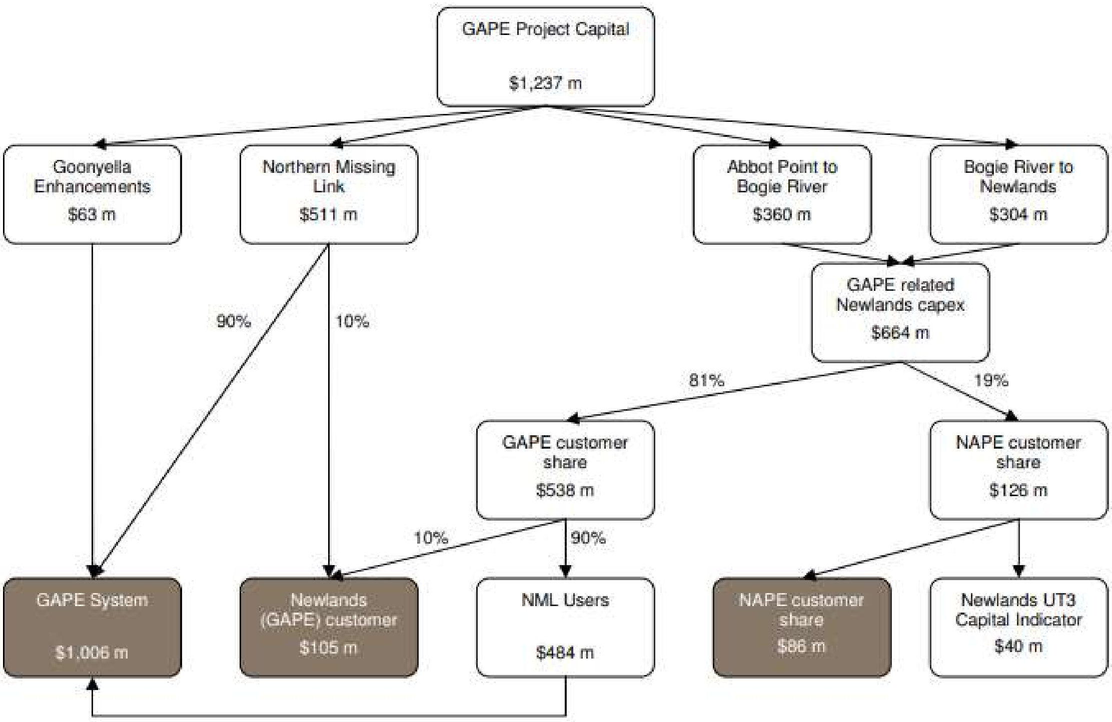
Bravus submission on the Aurizon's treatment of Newlands/GAPE Cost allocation of Renewals in the Annual Review of Reference Tariffs – FY22

In 2009, Newlands operated 5000 tonne train with 20t axles loads on 50 kg track at maximum speeds of 80 km/hr. The BRTT was 124% and the nameplate of the system was " about 19Mtpa rail capacity". The Newlands system operated at modest levels of contracted capacity at a low cost. In FY12 the AT2- AT4 revenues was equivalent to $1.75/tonne. Newlands notably delivered almost 17Mt against a nameplate capacity of 19Mt (exc NAPE) in FY10.

Table 1. Pre GAPE Newlands Thoughput						
	FY6	FY7	FY8	FY9	FY10	FY11
Mtpa	11.6	11.2	11.7	14.2	16.9	15.1

In light of this, the Newlands RAB required no additional capacity upgrades during the GAPE Expansion. The original GAPE project only allocated $40m for inclusion into UT3 Renewals/Capital Indicator. Noting that Aurizon Network in this case was able to identify specific Newlands Renewals as an "Incremental Cost" to the GAPE project.



The introduction of the 6800t H82 trains, associated signalling & track upgrades with GAPE was not for the benefit of Newlands mines. Aurizon identified ….

"As part of value engineering process, Aurizon Network identified that [GAPE] *customers would realise a lower TCO by operating larger trains (H82) at a higher BRTT (160%) than if additional infrastructure (passing loops and track duplication) was built to retain the contracted BRTT."*

Aurizon Network acknowledge in 2010 that GAPE users should be responsible for Incremental Costs ….

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"As coal carrying train services for GAPE customer mines are utilising newly created rail infrastructure not currently included in the CQCR, any costs not already included in existing Reference Tariffs or System Allowable Revenues, including the capital and operating costs associated with the Rail Infrastructure from the GAPE customer mines to Abbot Point, are incremental to the GAPE project."

Cost were allocated on the basis of user pays to promote economic efficiency in keeping with the current Expansion Pricing Principles.

The current AU defines

Incremental Costs *(as) Those costs of providing Access, including capital (renewal and expansion) costs, that would not be incurred (including the cost of bringing expenditure forward in time) if the particular Train Service or combination of Train Services (as appropriate) did not operate, where those costs are assessed as the Efficient Costs and based on the assets reasonably required for the provision of Access.*

and

Common Costs *(as) Those costs associated with provision of Rail Infrastructure that are not Incremental Costs for any particular Train Service using that Rail Infrastructure.*

Common Costs and Incremental Costs are mutually exclusive and the classification of Renewal costs into these separate categories given the Expansion Pricing Principles will lead to costs being potentially allocated differently between GAPE and Newlands systems. The definition of Incremental Costs contemplates Renewal costs amongst other costs and notably does not apply a time restriction around this qualification, it simply assesses the impact at the margin against the "without" starting point. The **Expansion Pricing Principles** outlined in Part 6 at clause 6.4.1 of the AU are as follows -

i. *Expanding Users should generally pay an Access Charge that reflects at least the full incremental costs (capital and operating) of providing additional Capacity;*
ii. *subject to clause 6.4.1(d)(iv), Non-Expanding Users should not experience a material increase in Reference Tariffs due to an Expansion triggered by Expanding Users;*
iii. *if Expanding Users face a higher cost than Non-Expanding Users, a zero contribution to Aurizon Network's Common Costs from Expanding Users is* ***generally acceptable****;*
iv. *and an allocation of the Expansion Costs to Non-Expanding Users may be appropriate where an Expansion has clear benefits to those Non-Expanding Users*

Given the higher tariffs of GAPE, any Newlands Renewals classified as Common Costs would under these principles be likely allocated to the Newlands system (if the Expansion Pricing Principle (iii) is "generally acceptable") and Newlands Renewals classified as Incremental GAPE costs would be alllocated to the GAPE system .

From a regulated revenue perspective, Aurizon Network should be indifferent to the treatment of these costs from an overall allowable revenue perspective. Aurizon in a publicly available presentation to investors (see footnote), proposed that total GAPE revenue or Maximum Capacity Revenue is a fixed annual amount made up of building blocks. These building blocks include a regulated revenue and commercial charges. The commercial charges include a Monthly GAPE Fee and the GAPE Annual Adjustment. The later fee being charged if the Total Gape Revenue collected during the course of the year does not deliver the predetermined (fixed) MCR. These commercial charges are explained in the presentation as the incremental difference between the regulated

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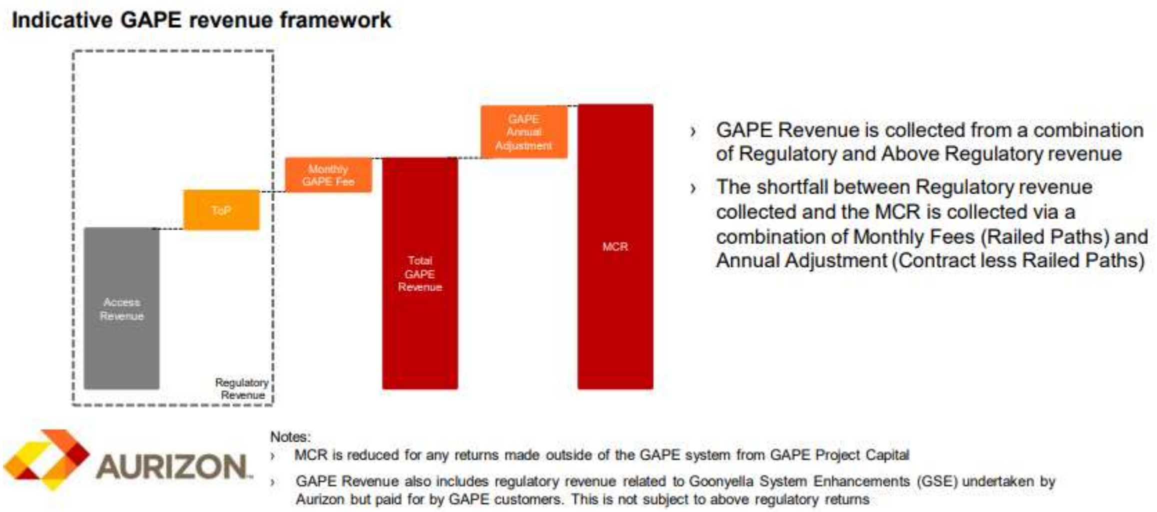
component and a proposed fixed MCR.   Given the fixed nature of MCR, it would appear that increasing the GAPE MAR/ GAPE access revenue will not increase Aurizon Network's overall GAPE revenue. Given the fixed nature of the GAPE MCR, it would appear that Aurizon has a strong incentive to shift GAPE Access Revenue to the Newlands MAR in order to maximise its overall returns between the two systems.   Aurizon Network will maximise their annual revenue by GAPE users avoiding contributions to Newlands Common Costs and by keeping GAPE's share of Newlands Capital and Newlands's Renewals in the Newlands RAB & MAR.   Aurizon appears conflicted in its allocation of costs between the systems as well as the allocation of costs between Common Costs and Incremental Costs.



It would appear, that as a collective, GAPE users would be indifferent whether or not Regulatory Revenue from allocation of Newlands Incremental costs and /or an allocation of a share of Newlands Common costs was increased because the GAPE total access cost remains at the same fixed GAPE MCR.

In the FY22 Annual Review of Reference Tariffs , Aurizon Network have allocated almost all Newlands Renewals costs as Newlands System Common Costs. In doing so, Aurizon appear to rely on the Expansion Pricing Principle (iii) which includes an undefined term "generally acceptable" still applying. Bravus is interested in the term "generally acceptable" and notes from the QCA's comments in 2013 that high GAPE tariffs, low GAPE volumes and GAPE project timing considerations influenced their support for excluding a GAPE contribution to Newlands Common Costs early on in GAPE history.

In 2021, the QCA should review the allocation of Common Costs between the systems and whether it remains   "generally acceptable" for GAPE Users not to contribute to a fair share of Newlands Common Costs. Bravus is of the view that it is not generally acceptable for GAPE users not to contribute to Newlands Common Costs   -

- as GAPE rolls on into the 10th year of railing
- given the FY22 forecast GAPE volumes now exceed forecast Newlands volumes
- given GAPE users at least as a collective would be indifferent around the inclusion of Common costs into the GAPE MAR
- given that the real cost of GAPE track access is capped at a commercially agreed high cost MCR, in a separate system. Ultimately it is the level of MCR that has provided a

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disincentive for GAPE volumes/reduced unit costs and it is likely to have contributed to some stranded GAPE capacity. The real tariff differential between the systems used in Expansion Pricing Principle (iii) is at least in part a GAPE commercial construct whilst MCR provides a disincentive for additional GAPE volume ie MCR is a driver of volume used in the assessment of the differential tariffs in Expansion Pricing Principles.

Recommendations:

Bravus would recommend costs be allocated to promote the correct price signals for each system in keeping with the Expansion Pricing Principles -

- All GAPE upgrades in the Newlands system remain as Incremental capital as originally proposed.
- all Renewals which upgrade the Newlands systems to the 26tal should constitute part of the GAPE RAB in keeping with the original GAPE allocation of Incremental capital
- GAPE users make a contribution to Newlands Renewals classified as Incremental costs on the basis of forecast GAPE tonnage share of total forecast throughput.
- GAPE users make a contribution to Newlands Renewals classified as Common Costs on the basis of forecast GAPE tonnage share of total combined forecast throughput.

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Bravus Comments on Aurizon's Reasons for their proposed treatment of Allocation of GAPE/Newland Costs

Aurizon Reasons	Bravus Comment
> the Newlands and GAPE Reference Tariffs are each less than the respective stand-alone costs and greater than the respective incremental costs for each system and are therefore consistent with the pricing limits;	The applications of Pricing Limits is not the appropriate determinant here. See Expansion Pricing Principles for guidance. Noting in any case in the Application of Pricing Limits there should be no Cross subsidy between Train Services. In the absence of correct allocation of Incremental costs/Common costs of GAPE to the GAPE tariff this statement remains disputable.
> the current Newlands RAB is not cost reflective of the 26 tonne axle load (TAL) services currently operating within the Newlands System;	26tal services were introduced to minimise the capital cost of capital for the benefit of GAPE. It was not required to deliver Newlands capacity. All capital costs and renewals associated with upgrading Newlands infrastructure from 20tal to 26tal should be for the account of GAPE users.
> the inclusion of the Newlands asset replacement expenditure in the Newlands Reference Tariff progressively transitions the price of the legacy 20TAL system to the more efficient 26TAL cost of service delivery over a long period of time;	GAPE users should be responsible for Incremental costs of a 26tal system over and above the costs of a 20tal system replacement as a principle. GAPE users should be allocated their Incremental costs of Newlands Renewals/Capital Replacements because of increased Newlands system volumes using shared infrastructure. If Newlands Renewal costs are Common Costs they should also be allocated on the basis of each system forecast volumes. There are no time limits associated with the definition of Incremental Costs.
> the annual net impact on the Newlands RAB value and the Newlands System Allowable Revenues does not result in material price shocks and therefore does materially affect allocative or productive efficiency;	Bravus has raised concerns around the apparent conflict of interest Aurizon Network has around shifting costs from GAPE to Newlands users and Cost allocation. Supply chains compete against supply chains. The current proposal by Aurizon Network will reduce the economic efficiency of the

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	Newlands by wrongly allocating costs to this system.
> the resultant GAPE Reference Tariff provides stronger price incentives to maintain and increase the utilisation of the Newlands Coal System at expiry of the GAPE contractual arrangements;	Aurizon additional commercial returns above and beyond the GAPE regulated revenue have likely contributed to underutilisation of GAPE/stranding of some GAPE capacity. GAPE was developed as a pressure relief valve for Goonyella during high coal prices it was not developed to enhance economic efficiency of Newlands. The availability of spare Goonyella capacity at the expiry of GAPE contractual arrangements will dictate the utilisation of GAPE in future years. Costs should be allocated in a manner to ensure each system is meeting its own Newlands Incremental and Common costs. Noting that this approach also values Newlands expansion tonnes and aligns with the Expansion Pricing Principles.
> the contract and demand positions of Newlands Users materially differ from the pre-GAPE Newlands contracted positions. It is both inefficient and inequitable for new or additional demand to maintain access at an access price which is not reflective of the cost of service delivery;	Supply chains compete against supply chains. Long term mine and infrastructure investments have been made on the basis of predictable and responsible governance of the Newlands Network. The cost of the Newlands service is influenced by the allocation of cost between Goonyella and Newlands. Expansion costs should be allocated to promote economic efficiency by ensuring the relevant Newlands costs are allocated correctly to each system. Newlands forecast demand remains within the historic nameplate capacity of 19Mt. Newlands pricing would be substantially higher without the inclusion of Bravus tonnes.
> GAPE project costs are not included in the Newlands Reference Tariff and therefore, Aurizon Network's approach satisfies and remains consistent with the approved cost allocation methodology for the GAPE Project Costs; and	In the interest of economic efficiency, each system should be responsible for it own contribution to Newlands Incremental Costs and Newlands Common Costs. In terms of GAPE project costs - Have all GAPE project signalling commitments been completed? Are there FY22 Renewal costs that should have been included in the GAPE project costs? Why do the FY22 Newlands Renewals include replacement of

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	20tal track, sleepers and bridges? Are these "overlooked" GAPE project costs? Should the ICAR identify a capacity shortfall in the Newlands section of track following the IE review (& given Newlands historic ability to deliver against the 19Mt ex NAPE nameplate capacity), which system would these capital costs be allocated against ?
> It better reflects the significant indirect benefits provided to Newlands Users from the increased above rail efficiency seen through an increase in the average train payload between FY10 and FY20 of 45% and a material increase in competition from system interoperability.	Bravus agrees that there are indirect benefits for its operations from the H82 fleet but would question this relevance at the current levels of Newlands throughput. Forecast Newlands volumes do not exceed the historic Newlands capacity of 19Mt. GAPE Incremental costs and share of Newlands Common costs should be allocated to the GAPE system to promote economic efficiency and alignment with the Expansion Pricing Principles.

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