

File Ref: 1380157

18 July 2019

Mr Michael Riches  
Group Executive Network  
Aurizon Network Pty Ltd  
GPO Box 456  
Brisbane Qld 4001

Dear Mr Riches

**Aurizon Network's 2019 Electric Traction DAAU—decision**

The Queensland Competition Authority has approved Aurizon Network's 2019 Electric Traction draft amending access undertaking (the 2019 AT5 DAAU).

The QCA assessed the appropriateness of the 2019 AT5 DAAU overall, and its individual aspects, having regard to section 138(2) of the QCA Act.

In doing so, the QCA has accepted Aurizon Network's proposal to reallocate variable connection charges between the electric reference tariff components, despite Aurizon Network not seeking to make consequential changes to the tariff components as part of the 2019 AT5 DAAU. The QCA considers this reasonable in the circumstances, given the QCA has already considered, and will continue to assess, other DAAUs that have sought to amend the reference tariff components. On that basis, a separate process will still be required for the QCA to consider any new tariff components to reflect any subsequent reallocation of variable connection charges.

The attached decision notice sets out the basis for the QCA's final decision.

This letter and decision notice will be published on the QCA website for stakeholders' information.

If you have any questions about this decision notice, please contact Ann Jones on (07) 3222 0574.

Yours sincerely



Charles Millsteed  
Chief Executive Officer

cc: *Jon Windle, Aurizon Network, Manager—Regulation*

## DECISION NOTICE

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### AURIZON NETWORK'S 2019 ELECTRIC TRACTION DAAU—DECISION

18 July 2019

The Queensland Competition Authority has approved Aurizon Network's 2019 Electric Traction draft amending access application (2019 AT5 DAAU), under section 142(2) of the *Queensland Competition Authority Act 1997* (QCA Act).

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#### Background

Aurizon Network installed and maintains electric traction infrastructure in its Goonyella and Blackwater lines of its network. Access holders who use electric locomotives pay an electric access tariff (AT5) that recovers the capital, maintenance and operating costs for Aurizon Network's electric infrastructure as well as variable charges that energy providers charge Aurizon Network for use of their transmission networks. Under the 2017 access undertaking (UT5), any over- or under-recovery of AT5 revenues is reconciled during the annual revenue adjustment process (sch. F, cl. 4), which will vary future AT5 charges paid by users of electric traction services.

Aurizon Network has sought to amend the electric traction pricing framework previously, most recently through its 2018 Electric Traction DAAU (2018 AT5 DAAU) under the 2016 access undertaking (UT4).<sup>1</sup> The QCA refused to approve the 2018 AT5 DAAU due to replacement of UT4 with UT5.<sup>2</sup> However, the QCA published its preliminary views on the proposed arrangements<sup>3</sup> in the interests of building on that work, and to assist in stakeholder consideration and engagement, in the event Aurizon Network wished to have a new or modified proposal assessed under UT5.

#### Aurizon Network's 2019 Electric Traction DAAU

Aurizon Network submitted its 2019 AT5 DAAU in May 2019, proposing changes to UT5 to:

- provide for variable connection charges to be reallocated from the AT5 cost base to the electric energy charge (EC)

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<sup>1</sup> The QCA refused to approve Aurizon Network's 2017 AT5 DAAU in August 2018. The QCA has also published draft decisions proposing to refuse to approve Aurizon Network's 2013 and 2011 AT5 DAAs. The previous DAAU proposals, stakeholders' comments on them and the QCA's responses are available on the QCA website.

<sup>2</sup> QCA, *Aurizon Network's 2018 Electric Traction Draft Amending Access Undertaking*, decision, March 2019, pp. 1–2.

<sup>3</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, pp. 2–3.

- establish a process for future electric infrastructure investment that includes a customer vote and QCA pre-approval for large capital investment in the electric traction networks (exceeding \$20 million, aggregated)
- provide for Aurizon Network to recover some electric infrastructure costs from diesel traction users when electric traction utilisation falls below specific levels.

Aurizon Network said the 2019 AT5 DAAU builds on its previous AT5 DAAUs, specifically the 2018 AT5 DAAU, and sought to 'address all concerns raised by the QCA in its Preliminary View.'<sup>4</sup>

### Further submission

Aurizon Network made a further submission on its 2019 AT5 DAAU that indicated the potential changes to the reference tariffs components in schedule F of UT5 that would result should its proposal to reallocate variable connection charges from AT5 to EC be approved.<sup>5</sup> The QCA published this submission for other stakeholders to take into consideration in their own submissions to the DAAU.

### Regulatory process

Under the QCA Act, Aurizon Network can submit to the QCA a voluntary DAAU to amend the approved access undertaking (s. 142(1)).<sup>6</sup> The QCA must consider the DAAU and either approve, or refuse to approve, the DAAU (s. 142(2)), having regard to the matters mentioned in section 138(2) (s. 143(2)).

The QCA assessed Aurizon Network's 2019 AT5 DAAU according to the timelines below.

<i>Date</i>	<i>Action</i>
17 May 2019	Aurizon Network submitted the 2019 AT5 DAAU
20 May 2019	The QCA published the 2019 AT5 DAAU and invited submissions
11 June 2019	The QCA published Aurizon Network's further submission on the 2019 AT5 DAAU
24 June 2019	Submissions period closed—the QCA received one submission by the due date and two submissions after the due date
18 July 2019	The QCA published its decision to approve the 2019 AT5 DAAU

The documents mentioned above are available on the [QCA website](#).

In this instance, the QCA has chosen to proceed to a decision on the 2019 AT5 DAAU without first sharing its views on the proposal with stakeholders. The QCA considers the interests of stakeholders will be served by a timely decision. The QCA notes the nature of the proposed amendments are broadly consistent with the QCA's previous views on appropriate arrangements for electric traction pricing, and in this instance, the QCA has not been provided any reason to change them. In addition, stakeholders did not raise substantive objections to the proposed amendments.

The QCA considers it has met its statutory requirements in proceeding in this way.

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<sup>4</sup> Aurizon Network, *2019 Electric Traction Draft Amending Access Undertaking Submission*, May 2019 (Aurizon Network supporting submission), p. 9.

<sup>5</sup> Aurizon Network, submission to the QCA, *Aurizon Network's 2019 Electric Traction DAAU*, June 2019 (Aurizon Network submission), pp. 1–4.

<sup>6</sup> All clause references hereafter refer to the QCA Act, unless otherwise stipulated.

## Stakeholders' submissions

The QCA provided stakeholders with an opportunity to comment on Aurizon Network's 2019 AT5 DAAU and received three submissions, from Aurizon Coal<sup>7</sup>, BMA<sup>8</sup> and Peabody<sup>9</sup>.

The QCA had regard to stakeholder comments on this DAAU in making its decision, in accordance with section 138(3)(d). Additionally, and in accordance with section 173(1)(c)<sup>10</sup>, the QCA took stakeholder comments on the 2018 AT5 DAAU into consideration, where relevant—given the 2018 AT5 DAAU was not materially different from the 2019 AT5 DAAU and the closeness in timing of the regulatory processes.

The QCA notes Aurizon Network's position that a consensus view on the benefits, or otherwise, of its proposal is unlikely to be achieved given the 'competing commercial interests of producers, and their haulage providers'.<sup>11</sup> While the QCA acknowledges the apparent support (or at least the lack of opposition) for the 2019 AT5 DAAU<sup>12</sup>, it has not simply approved the proposal on that basis. Rather, this is one input the QCA has considered to inform its assessment under the factors listed in section 138(2).

## QCA assessment and decision

The QCA's decision is to approve Aurizon Network's 2019 AT5 DAAU, under section 142(2) and in compliance with section 143. In making its decision, the QCA had regard to the assessment criteria (s. 138(2)) in considering the:

- principles of the proposed amendments to the electric traction pricing framework
- accuracy of the corresponding amendments to UT5.

The QCA considers the 2019 AT5 DAAU sufficiently addresses the concerns for the electric traction pricing framework, and matters raised by the QCA and stakeholders in previous proposals. The QCA's assessment of the amendments raised in Aurizon Network's 2019 AT5 DAAU is outlined below.

## Reallocating variable connection charges

The QCA considers, in principle, that reallocating the variable connection charges from the AT5 to the EC components is likely to improve efficiency of pricing (ss. 138(2)(a), (g)) without adversely affecting Aurizon Network's legitimate business interests (s. 138(2)(b)). The reallocation would ensure only electric users bear variable costs of electric traction if the socialisation of under-recovered revenues is triggered (ss. 138(2)(e), (h)).

The QCA notes Aurizon Network did not include amended AT5 and EC tariffs components in schedule F of UT5 to reflect the reallocation of variable connection charges in the 2019 AT5 DAAU.<sup>13</sup>

Aurizon Network said that it had not proposed amendments to tariff components in order to 'simplify the assessment of the [2019] Electric Traction DAAU given the QCA has already reviewed the reallocation process [for

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<sup>7</sup> Aurizon Coal, submission to the QCA, *Aurizon Network's 2019 Electric Traction DAAU*, June 2019 (Aurizon Coal submission).

<sup>8</sup> BMA, submission to the QCA, *Aurizon Network's 2019 Electric Traction DAAU*, June 2019 (BMA submission); The QCA received this submission after the deadline but found it appropriate to consider for its decision.

<sup>9</sup> Peabody, submission to the QCA, *Aurizon Network's 2019 Electric Traction DAAU*, July 2019 (Peabody submission); The QCA received this submission after the deadline but found it appropriate to consider for its decision.

<sup>10</sup> The QCA may inform itself on any matter relevant to the investigation in any way it considers appropriate.

<sup>11</sup> Aurizon Network supporting submission, p. 7.

<sup>12</sup> Aurizon Network supporting submission, pp. 6–7.

<sup>13</sup> Aurizon Network, *2019 Electric Traction Draft Amending Access Undertaking*, UT5 mark-up (UT5 mark-up), May 2019, pp. 395, 399.

the 2018 AT5 DAAU] and would also be considering a number of other draft amending access undertaking simultaneously.<sup>14</sup>

This has created an inconsistency between the applicable reference tariff components provided for in schedule F and the proposed definition of the EC component.<sup>15</sup> The QCA has previously been concerned that failing to adjust the tariff components to reflect a new reallocation approach may create uncertainty about when, and how often, the reallocation will occur—and could distort any socialisation of AT5 under-recovery, since the amount will be larger than if AT5 costs had been reallocated.<sup>16</sup> On this, the QCA said:

If Aurizon Network proposes to reallocate the variable connection charges to the EC in a future DAAU, it will need to ensure that their reallocation method is clearly documented and reflected in the reference tariffs.<sup>17</sup>

While Aurizon Network has not sought to adjust the reference tariff components in this instance, it has provided indicative values<sup>18</sup> to provide 'clarity as to the proposed treatment of the reallocation of variable connection charges should the Electric Traction DAAU be approved'.<sup>19</sup> The QCA also verified the implementation of this transfer through confidential modelling provided by Aurizon Network.

Providing indicative values reduces some uncertainty on the outcomes of the reallocation for stakeholders. Additionally, the QCA understands that amendments to the tariff components (or lack thereof) for a reallocation of charges would not result in a change to the total charges paid by electric traction users, or be necessarily consequential if the socialisation of under-recovered electric revenues is not triggered. The QCA views this is likely the case in the near future.

The QCA also acknowledges that while it will assess each DAAU currently before it on its merits, there is potential for overlap in proposed amendments, including for reference tariffs in schedule F of UT5.<sup>20</sup>

In having consideration for all aspects of this matter as outlined above, and with a view to the QCA accepting other components of the 2019 AT5 DAAU as detailed below, the QCA's position is it is reasonable to also accept the proposal to reallocate variable connection charges, without the corresponding amendments to the AT5 and EC tariff components. In this instance, the QCA views the potential benefits from implementing the full suite of amendments set out in the AT5 DAAU outweigh any remaining uncertainty or lack of clarity and transparency around the tariff components that will ultimately apply as a result of providing for reallocation. The impact of any uncertainty around the tariff components is only likely to be realised in the longer term, where socialisation is more likely to occur if it occurs at all. However, the QCA considers sufficient opportunity exists for Aurizon Network to seek amendments to the AT5 and EC tariff components to reflect the full reallocation of the variable connection charges, and is encouraged by Aurizon Network's commitment to seek to update the reference tariffs accordingly. In doing so, Aurizon Network will need to ensure that its reallocation method is clearly documented.

### Process for future electric investment

The QCA considers that requiring customer voting for significant investments in electric traction will reduce information asymmetry among access seekers and holders (ss. 138(2)(e), (h)). The QCA also recognises the customer vote is non-binding but the proposed inclusion of mandatory QCA preapproval<sup>21</sup> could further reduce

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<sup>14</sup> Aurizon Network submission, p. 1.

<sup>15</sup> UT5 mark-up, p. 359.

<sup>16</sup> QCA, *Aurizon Network's 2017 Electric Traction DAAU*, final decision, August 2018, p. 20.

<sup>17</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 2.

<sup>18</sup> Aurizon Network submission, pp. 3–4.

<sup>19</sup> Aurizon Network submission, p. 1.

<sup>20</sup> QCA, *Aurizon Network's Reference Tariff Variation DAAU*, decision, June 2019, p. 3.

<sup>21</sup> UT5 mark-up, p. 341.

the likelihood of inefficient investment in electric infrastructure, consistent with part 5 of the QCA Act (s. 138(2)(a)), and is in the interests of Aurizon Network and the public (ss. 138(2)(b), (d)). The QCA finds the proposed drafting amendments to UT5 clearly establish the intended process for future electric infrastructure investment.

In response to previous stakeholder concerns on the validity of a preapproval for delayed works<sup>22</sup>, the QCA considers UT5 contains sufficient provisions to account for delays in completion of preapproved capital works that could impact the prudence and efficiency of the investment. Access holders and seekers who are voting (identified as 'interested participants' under sch. E, cl. 4.2 of UT5) may express views on the capital expenditure works during the voting process (sch. E, cl. 4.1 of UT5). Additionally, the QCA's preapproval allows it to specify conditions for preapproval (sch E, cl. 2.2(e) of UT5), including:

- (iii) the period of time in which the approval has effect (and if the project is not completed within the nominated time, the QCA may decide the approval ceases to have effect).

The QCA's view is Aurizon Network has proposed a process for future investment in electric traction that is transparent, and provides greater certainty to itself and its customers.

### Recovery of electric infrastructure costs

The QCA maintains its view that allowing Aurizon Network to socialise any under-recovery of AT5 revenues provides Aurizon Network revenue certainty and could dampen a price spiral that may lead to asset stranding; but socialisation should only be triggered in limited circumstances, where the likelihood of electric asset stranding is clear and present.<sup>23</sup> This is because socialisation shifts costs and risks between users, depending on the mix of users, their past traction choices and the composition of their contracted access rights.

Effective implementation (through the specification of the socialisation mechanism and associated thresholds) is critical to balance these competing factors—and will be required to ensure socialisation of costs occurs as a last resort.

#### *Socialisation mechanism*

Aurizon Network adopted its multi-step mechanism from its 2018 AT5 DAAU,<sup>24</sup> whereby under-recovered AT5 revenues would be socialised through an Electric Revenue Adjustment<sup>25</sup> if:

- (1) the relevant reference tariff is a System Reference Tariff (as defined in cl. 12.1 of UT5)
- (2) there is a Decline in Electric Utilisation<sup>26</sup> for the relevant year
- (3) the Electric Utilisation Level<sup>27</sup> is less than the Electric Utilisation Floor<sup>28</sup> for the relevant system
- (4) there is an AT5 Revenue Shortfall<sup>29</sup> for the relevant year.

The QCA considers that the socialisation approach has merit given the proposed implementation, including the choice of various threshold levels (as discussed below). The QCA finds the drafting proposed, including clarity on the proposed definition of 'Decline in Electric Utilisation',<sup>30</sup> establishes a transparent mechanism for socialisation.

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<sup>22</sup> Fitzroy Australia Resources, submission to the QCA, *Aurizon Network's 2018 Electric Traction DAAU*, December 2018, p. 2.

<sup>23</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 2.

<sup>24</sup> Aurizon Network supporting submission, p. 10.

<sup>25</sup> UT5 mark-up, pp. 265, 379.

<sup>26</sup> UT5 mark-up, p. 263.

<sup>27</sup> UT5 mark-up, p. 265.

<sup>28</sup> UT5 mark-up, p. 265.

<sup>29</sup> UT5 mark-up, p. 252.

<sup>30</sup> UT5 mark-up, p. 263.

### *Electricity capacity factor*

Aurizon Network proposed electric capacity factors—representing the maximum capability of the rail infrastructure to carry coal through electric traction—which are 94 per cent for Blackwater and 98 per cent for Goonyella. These factors are used in part of the second step of the socialisation mechanism to determine if there was a decline in electric traction utilisation.<sup>31</sup> The QCA considers the proposed factors reasonable representations of the capability of electric traction infrastructure for each system.

The QCA previously recommended Aurizon Network to address stakeholder concerns<sup>32</sup> by explaining its inclusion of push/pull operations in the context of the electric capacity factor.<sup>33</sup> In regards to the 2019 AT5 DAAU, the QCA finds Aurizon Network's approach and justification for only including the associated volumes of push/pull services on track sections that have the option of electric traction<sup>34</sup> sensible and adequate to address these concerns.

### *Electric utilisation floor*

Aurizon Network proposed utilisation floors of 65 per cent for Blackwater and 71 per cent for Goonyella.<sup>35</sup> It stated these thresholds were based on the QCA's preliminary views on the 2018 AT5 DAAU<sup>36</sup>, which were the upper bounds of what the QCA considered appropriate ranges for the socialisation thresholds at the time.<sup>37</sup> The QCA notes stakeholders were concerned that the proposed threshold levels may be set too low,<sup>38</sup> and sought greater transparency around the rationale for the proposed threshold levels.<sup>39</sup>

The QCA considers the electric utilisation floors (thresholds) are a key determinant to the appropriateness of implementing the socialisation mechanism. An appropriate floor will ensure that socialisation is unlikely (only occurring when there is evident risk of asset stranding, and not for one-off shocks) but still be high enough that bypass is avoided.<sup>40</sup> This would appropriately balance the factors in section 138(2) by:

- facilitating clearer price signals in the AT5 price and aiding in efficient use of electric traction (s. 138(2)(a))
- allowing Aurizon Network to recover its efficient costs and manage electric traction bypass risks (ss. 138(2)(b), (g))
- preserving traction neutrality and promoting competition in above-rail markets (s. 138(2)(d))
- minimising the occurrence of socialisation, thereby ensuring consistency with interests of access holders who do not use electric traction and promoting efficient multi-part pricing (ss. 138(2)(e), (g)).

In its response to the 2018 AT5 DAAU, the QCA undertook a bottom-up approach and sensitivity analysis to better understand:

- the likely risk of asset stranding in each system (including past electric utilisation levels, distribution of egtk across users)

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<sup>31</sup> Aurizon Network, *2018 Electric Traction Draft Amending Access Undertaking Submission*, November 2018, p. 15.

<sup>32</sup> Pacific National, submission to the QCA, *Aurizon Network's 2018 Electric Traction DAAU*, December 2018, p. 14.

<sup>33</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 3.

<sup>34</sup> Aurizon Network supporting submission, p. 10.

<sup>35</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 3; Aurizon Network supporting submission, pp. 3, 12.

<sup>36</sup> Aurizon Network supporting submission, p. 12.

<sup>37</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 3.

<sup>38</sup> This means that electric tariffs would increase significantly before socialisation was triggered, potentially posing a risk to supply chain competition and the sustainability of electric traction.

<sup>39</sup> Aurizon Network supporting submission, pp. 11–12; Aurizon Coal submission, p. 1; BMA submission, p. 1; Peabody, p. 1.

<sup>40</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 3.

- the possible cost incentives for existing users to switch
- the impact of large electric hauls switching on whether the socialisation mechanism was triggered
- the possible impact of one-off shocks (like a flood event).

That analysis was largely based on confidential data, including individual haulage contracts, and indicated that the upper bound of a reasonable floor would be 65 per cent for Blackwater and 71 per cent for Goonyella. The QCA has not been presented with any further evidence to revise this view.

In approving the 2019 AT5 DAAU mechanism for socialisation and its implementation at the recommended threshold levels, the QCA maintains its view of 'socialisation of costs as a last resort'<sup>41</sup>, and Aurizon Network and operators would be likely to explore alternative measures prior to socialisation being triggered. Furthermore, the QCA notes Aurizon Network's intention to work with its customers to address concerns around the electric traction pricing framework which could include revisiting threshold levels to reflect changing market conditions, either at a regulatory reset or through a future DAAU.<sup>42</sup>

### Way forward

The QCA recently approved Aurizon Network's Reference Tariff Variation DAAU, on 24 June 2019. The QCA will continue its assessment of Aurizon Network's outstanding UT5 DAAU under the statutory criteria, having regard to and on the basis of the amendments approved by the Reference Tariff Variation and 2019 AT5 DAAUs.

For clarity, this approval does not include any amendments to the reference tariffs in schedule F of UT5—to reflect the reallocation of variable connection charges. Any future amendments to UT5, including updating the reference tariff components, should be proposed for the most recently updated version of the undertaking, incorporating the amendments from the approved Reference Tariff Variation and 2019 AT5 DAAUs.

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<sup>41</sup> QCA, *QCA's Response to the 2018 Electric Traction DAAU*, March 2019, p. 2.

<sup>42</sup> Aurizon Network supporting submission, p. 12.