

Decision

Reference Tariffs for Middlemount to DBCT

June 2014

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THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS

The Queensland Competition Authority (QCA) is an independent statutory authority to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

In 2012, that role was expanded to allow the QCA to be directed to investigate, and report on, any matter relating to competition, industry, productivity or best practice regulation; and review and report on existing legislation.

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AURIZON NETWORK PROPOSAL

Middlemount Mine

The Middlemount coal mine is located at the 125.53 kilometre point on Aurizon Network's Goonyella rail system in the central Queensland coal region (CQCR), approximately 90 kilometres north-east of Emerald. The mine is owned and operated as a joint venture between Peabody Energy Australia and Yancoal Australia, and commenced production in November 2011.

The Middlemount mine has built its own private rail infrastructure, electric and non-electric, from the mine load-out to the point of connection to the Goonyella system, at its own cost. The private infrastructure remains owned by the Middlemount mine. Middlemount is the first greenfield mine development in the CQCR, since the commencement of the first Aurizon Network (then Queensland Rail) access undertaking, for which its rail infrastructure is privately owned.

Middlemount has entered a fixed-term transfer of contractual entitlements from another Goonyella mine to the Dalrymple Bay Coal Terminal (DBCT). The fixed-term transfer expires on 30 June 2014.

To date, Middlemount, via its train operator (Pacific National), has been paying an interim access charge for access to the CQCR, determined in accordance with the relevant access agreement.

2010 undertaking

Clause 6.4.2(b) of Aurizon Network's 2010 access undertaking (UT3) provides that:

Unless otherwise agreed with the QCA, where a new coal mine is developed and Train Services servicing that mine will utilise Rail Infrastructure in the Central Queensland Coal Region, the Train Services travelling between the mine (or, where the mine is or will be located on Private Infrastructure, the point where the Private Infrastructure connects to the Rail Infrastructure) and its most common destination will be incorporated in a new or existing Reference Train Service in a manner consistent with and subject to the requirements of Schedule F. (For the avoidance of doubt, where the mine is or will be located on Private Infrastructure, the loading point for the new Train Service will be used for the purpose of calculating the Private Incremental Costs for and describing that Train Service even though that loading point is located adjacent to Private Infrastructure).

The relevant requirements of Schedule F are contained in clauses 4.1.1 and 4.1.2 of Part B of that schedule.

Clause 4.1.1 of Part B of Schedule F provides that:

Unless otherwise agreed with the QCA, where a coal carrying Train Service is operating within an existing Individual Coal System Infrastructure, or is utilising an existing or new branch line connecting to that Individual Coal System Infrastructure and is not a Cross System Train Service, it will be expected to make a minimum contribution towards Aurizon Network's Common Costs determined as the sum of the following components of the Reference Tariff that applies to that Individual Coal System Infrastructure:

- (a) AT2 (adjusted for any variation that will be made pursuant to Clause 3 of Part A for that Train Service); and*
- (b) fifty percentage points (50%) of AT3 for the distance that the Train Service will travel on the mainline for the Individual Coal System Infrastructure.*

Clause 4.1.2 of Part B of Schedule F provides that:

In order to reflect the requirements of Subclause 4.1.1, the Reference Tariff applicable for a new coal carrying Train Service will be the higher of (on a \$/ntk basis):

- (a) *the Reference Tariff for the relevant Individual Coal System Infrastructure; or*
- (b) *the sum of the new coal carrying Train Service's Private Incremental Costs (if any), the Incremental Costs of using any Rail Infrastructure specifically related to the new coal carrying Train Service and the required minimum Common Cost contribution determined in accordance with Subclause 4.1.1,*

provided that the Access Charge payable to Aurizon Network for the operation of that new coal carrying Train Service is calculated as the applicable Reference Tariff less the Private Incremental Costs (if any).

Tariff proposal

On 11 April 2014, in accordance with UT3, Aurizon Network submitted for approval by us an application proposing new reference tariffs for the train service between the Middlemount mine and DBCT. The application was supported by provision of a confidential financial model.

Aurizon Network's proposal is for 2011-12, 2012-13 and 2013-14, with the reference tariffs to be backdated to November 2011. The net difference between the revenue that would be collected under the reference tariffs, and the revenue collected under the interim access charges, is to be collected from the access holder.

The proposed tariffs include a discount to the Goonyella system reference tariff, with the access holder to pay:

- for AT1-4: the AT1 reference tariff plus the train service's minimum contribution to common costs (CCC)
- for AT5: the AT5 reference tariff less the private capital costs associated with the electric infrastructure.

Aurizon Network said its proposal is consistent with the pricing principles contained in UT3, and the proposed pricing principles for the 2013 draft access undertaking (UT4), for situations where a spur line is fully owned by Aurizon Network but is subject to an Access Facilitation Deed (AFD).

Aurizon Network assumed the volumes Middlemount contracted through the fixed-term transfer were included in the original UT3 volume forecasts (from a different mine) and therefore would have been anticipated when maintenance and operating costs allowances for the UT3 period were set. Therefore, Aurizon Network said no adjustment to these allowances is necessary.

Aurizon Network said, as Middlemount had funded and owns its spur line, these costs cannot be added to the AT2-4 and AT5 system allowable revenues or form part of an existing reference tariff for the Goonyella system. In order to recognise Middlemount's investment in its own spur line, Aurizon Network proposed to interpret clause 4.1.2(b) of Part B of Schedule F of UT3 as meaning that private incremental costs include capital costs associated with a spur line regardless of ownership.

If interpreted in this way, the resulting calculations indicate the sum applying in accordance with clause 4.1.2(b) will be higher than the sum applicable under clause 4.1.2(a) (i.e. the Goonyella system reference tariff) - and thereby the procedure in clause 4.1.2(b) should be used to determine the reference tariff.

Aurizon Network then considered the reference tariff applicable to the Middlemount to DBCT train service should reflect:

- a minimum CCC
- plus the private incremental costs
- plus incremental costs of using Aurizon Network rail infrastructure specifically related to the service (represented by the AT1 tariff component).

The proposed private incremental costs are based on information supplied to Aurizon Network by Middlemount. Aurizon Network noted no assessment of prudence of scope, standard and costs of the electric and non-electric capital costs has been conducted.

Aurizon Network calculated the minimum CCC for each year of its proposal in accordance with clause 4.1.1 of Part B of Schedule F of UT3 - i.e. as the AT2 reference tariff component for the Goonyella system plus 50% of the AT3 component (for the distance travelled on the mainline). Aurizon Network's proposed minimum CCC values are shown in Table 1.

Table 1 also shows the volumes used for the calculations - these are based on the fixed term transfer, which Aurizon Network considered was included in the approved system forecasts for 2011-12 and 2012-13 and Aurizon Network's system forecast for 2013-14.

The proposed reference tariffs are equivalent to the sum of the incremental maintenance component (AT1) plus the minimum CCC (AT2 and 50% of AT3) plus a discounted AT5. The proposed tariffs are also represented in Table 1, but shown as discounts to the relevant Goonyella system reference tariff components. (The proposed discount is presented here as applying equally to the AT3 and AT4 reference tariff components, which is consistent with Aurizon Network's proposed UT4 treatment but not the UT3 pricing principles. However, Aurizon Network said the total revenue to be collected is not affected by this variation in presentation).

Table 1 Middlemount to DBCT Proposed Reference Tariffs Summary

<i>Item</i>	<i>FY2012</i>	<i>FY2013</i>	<i>FY2014</i>
Minimum CCC (\$)	663,527	623,916	713,018
Net tonnes (Mtpa)	0.77	0.64	0.70
AT3 discount (\$/'000 ntk)	-3.66	-4.23	-3.40
AT4 discount (\$/nt)	-0.72	-0.84	-0.63
AT5 discount (\$/'000 egtk)	-0.93	-1.65	-1.82

Source: Aurizon Network Submission

Aurizon Network noted the practical effect of its proposal is to lead to marginally higher reference tariffs for other Goonyella system users, than would be the case in the absence of a discount for the Middlemount to DBCT train service. However, it said this impact is not material (around \$0.01 per net tonne).

Aurizon Network proposed to apply the discount from the date of QCA approval, but with the access charges backdated in accordance with the relevant access agreement, as described earlier.

Aurizon Network noted the fixed term transfer expires on 30 June 2014 and the reference tariffs proposed in its application are only for the three-year period ending on that date. For 2014-15 onwards, it proposes:

- where there is a further transfer, a new reference tariff be established based on the same principles as the present application (but with a separate application to the QCA needing to be made)
- where there is no transfer (i.e. for ad-hoc railings), the Goonyella system reference tariff will be applied (this does not require a separate application to the QCA).

STAKEHOLDER COMMENTS

We published Aurizon Network's proposal on our website and requested submissions from stakeholders. We received submissions from:

- Asciano
- BHP Billiton Mitsubishi Alliance (BMA)
- Middlemount Coal Pty Ltd (Middlemount)
- the Queensland Resources Council (QRC).

All four submissions generally supported Aurizon Network's proposal, but commented on aspects of importance.

BMA supported the proposal on the basis it is consistent with the UT3 pricing principles. It noted changes to the pricing principles are being considered as part of the assessment of the proposed UT4, but said it supports continued application of the UT3 principles to provide regulatory certainty - noting that the Middlemount project would have had a three to five year development phase and the owners would have relied heavily on the UT3 pricing principles for costing rail access requirements.

Middlemount and the QRC noted the limited amount of information made publicly available and emphasised the importance of us reviewing the information provided.

Middlemount and Asciano considered the fixed-term transfer should be treated as tonnages in excess of the UT3 Goonyella system forecasts, as they considered it unlikely the tonnages were included in the forecasts (given forecast volumes are generally lower than contracted volumes).

Interpretation

While all submissions generally supported the proposal, there was disagreement over the interpretation of the relevant provisions of UT3 (i.e. the mechanism for achieving the proposed outcome). In this regard:

- the QRC considered private incremental costs to be costs incurred by a third-party, not costs incurred by Aurizon Network. It said clause 4.1.2(b) of Part B of Schedule F of UT3 requires that the reference tariff be based on the addition of Middlemount's private incremental costs, Aurizon Network's incremental costs and the minimum CCC. It noted the additional requirement then included in clause 4.1.2 is that 'the Access Charge for the Train Service is the Reference Tariff less the Private Incremental Costs.' The QRC considered strict adherence to these requirements would mean the reference tariff should include the private incremental costs, but the access charge for Middlemount would then deduct these costs, giving the same result as proposed by Aurizon Network. However, the QRC's interpretation would limit the discount to Middlemount, while any later access seeker using the spur line would pay the undiscounted reference tariff. Nonetheless, the QRC did not object to Aurizon Network's proposal to discount the reference tariff rather than the access charge, as it assumed there is no likelihood of other access seekers using the spur
- Middlemount and Asciano considered capital costs for privately owned spur lines should be treated as common costs, so as to align their treatment with that of existing users' spur lines, where costs are socialised through inclusion in the relevant system RAB.

QCA ANALYSIS AND DECISION

In assessing Aurizon Network's proposal, we have considered the relevant obligations contained in UT3. We note Aurizon Network has:

- developed its application in accordance with the requirements of clause 6.4.2(b) of UT3
- calculated the proposed CCC in accordance with clause 4.1.1 of Part B of Schedule F of UT3
- based its calculation and application of the proposed discounts to tariffs on a particular interpretation of clause 4.1.2 of Part B of Schedule F of UT3.

We also note:

- Aurizon Network appears to have negotiated in good faith with Middlemount and Asciano to provide a fair outcome in a situation that differs from the previous norm (i.e. for a greenfield mine that owns its private rail infrastructure)
- the proposal appears to provide benefits to the parties involved, without significantly adversely impacting on existing access holders' rights and entitlements (noting the impact on other Goonyella system users is estimated to be higher tariffs of around \$0.01 per net tonne).

With regard to the submissions received from stakeholders, we note all four submitters were generally supportive of Aurizon Network's proposal.

We agree with BMA's view that it is appropriate to apply the UT3 pricing principles to the proposal, which the owners of the Middlemount mine would have relied on in costing rail access requirements, given that changes to the pricing principles proposed in UT4 have not as yet been approved. However, future proposals will need to be considered in the context of the timing and nature of the particular application, and how that might relate to the pricing principles in an approved undertaking in force at the time.

We have reviewed the information provided by Aurizon Network, including the confidential financial model, and are satisfied the proposed discounts to reference tariffs have been accurately calculated, in accordance with the interpretation of the UT3 provisions used by Aurizon Network. We also note the capital costs of the private infrastructure have been provided to Aurizon Network by Middlemount and a prudency assessment of these costs has not been conducted. Given the non-material impact of the proposal on other Goonyella system users, we do not consider a full prudency assessment is warranted, and are prepared to accept the costs reported by Middlemount as being prudent.

We note the view of Middlemount and Asciano that the fixed-term transfer should be treated as tonnages in excess of the UT3 Goonyella system forecasts. However, we do not consider this to be clear, as the approved system forecasts are based on an aggregate level assessment of likely tonnages in each system, with indicative projections for individual mines inevitably likely to be subject to considerable fluctuation. In any case, variations between the system forecasts and actual volumes that result in differences between forecast and actual system allowable revenues are reconciled on a NPV neutral basis through the revenue cap mechanism. Further, neither Middlemount nor Asciano have suggested this issue should be a reason for rejecting Aurizon Network's proposal.

Interpretation

We note the concerns raised by the QRC, Middlemount and Asciano regarding the interpretation of clause 4.1.2 of Part B of Schedule F of UT3 used by Aurizon Network in its application. As indicated earlier, Aurizon Network's interpretation is that private incremental costs include capital costs associated with a spur line, regardless of ownership of the spur line. This interpretation is based on the idea that private

incremental costs would normally be considered to be costs incurred by Aurizon Network, whether or not actually funded by a third-party.

The QRC's alternative view is that private incremental costs are costs incurred by a third-party, not costs incurred by Aurizon Network - noting the definition of private incremental costs in UT3 links them to private infrastructure, which is not owned or operated by Aurizon Network.

Our view is the interpretation favoured by the QRC appears to be more consistent with the exact wording of clause 4.1.2 than the interpretation proposed by Aurizon Network, and also consistent with the intent of the relevant clause as expressed in previous QCA decision documents. In that regard, we note our decision on the 2005 draft access undertaking, highlighted by the QRC:

that the total access charge be determined on the basis of the efficient cost of the private infrastructure and any QR infrastructure specifically related to the mine, plus the contribution to common costs. The access charge payable to QR would then be determined as this total access charge less efficient private infrastructure costs.¹

This suggests the costs of private infrastructure are not considered to be costs of Aurizon Network, which in turn has implications for the mechanism for calculating the revenue outcome.

In essence, Aurizon Network's proposal is to discount the reference tariff itself, while the QRC's interpretation is that the reference tariff should stay as calculated, with the access charge payable to Aurizon Network being a discount of the reference tariff. We consider the wording of the relevant clause, as quoted earlier, is more reflective of the QRC's view.

We also agree with the QRC that, in this case, there is no difference in the outcome, assuming no other access seeker uses the spur. Given the design and geographic location of the Middlemount spur, a relatively short spur and balloon loop, the likelihood of another access seeker seeking to use it is not high. In any case, the discounted reference tariffs proposed by Aurizon Network will only apply from 2011-12 to 2013-14, and we are confident no other access seeker will use the spur line in that period.

We do not find Middlemount's and Asciano's view that capital costs for privately owned spur lines should be treated as common costs, so as to be socialised through inclusion in the relevant system RAB, compelling. This is because the system RAB relates to the provision of the declared service. Section 250 of the *Queensland Competition Authority Act 1997* (the QCA Act) indicates that services provided via private infrastructure, not owned or leased by Aurizon Network or a related body corporate, are not part of the declaration (see section 250(4) of the QCA Act for specific reference to the status of extensions built on or after 30 July 2010).

Given the above, we prefer the QRC's interpretation of clause 4.1.2. However, we note there appears to be some ambiguity in the drafting of the relevant UT3 provisions - meaning more than one interpretation is potentially defensible. We will consider this matter further in the assessment of the proposed UT4, with a view to ensuring any such ambiguity in drafting is removed.

That said, as the outcome in terms of the access charge levied is the same under both the QRC's and Aurizon Network's interpretation of clause 4.1.2 of Part B of Schedule F of UT3, we have agreed to accept Aurizon Network's proposal. In that regard, we note clause 4.1.1, the requirements of which are then reflected in clause 4.1.2, commences with the codicil 'Unless otherwise agreed with the QCA.'

¹ QCA Decision, QR's 2005 Draft Access Undertaking (December 2005); p.155.

Decision

For the reasons outlined in this decision document, we have decided to approve Aurizon Network's application for new reference tariffs for the train service from the Middlemount mine to DBCT for the 2011-12, 2012-13 and 2013-14 years.

REFERENCES

Asciano, 14 May 2014. "Asciano submission on the Aurizon Network proposal for new reference tariffs for Middlemount to Dalrymple Bay Coal Terminal".

Aurizon Network, 11 April 2014. "Proposed new reference tariffs: Middlemount to DBCT".

BHP Billiton Mitsubishi Alliance, 16 May 2014. "Proposed new reference tariffs for Middlemount to Dalrymple Bay Coal Terminal".

Middlemount Coal Pty Ltd, 16 May 2014. "Submission: Proposed new reference tariffs for Middlemount to Dalrymple Bay Coal Terminal".

QCA Decision, QR's 2005 Draft Access Undertaking (December 2005).

Queensland Resources Council, 21 May 2014. "Aurizon Network's Proposed Middlemount Reference Tariff".