

File Ref: 1434713

17 December 2020

Ms Pam Bains
Group Executive Network
Aurizon Network Pty Ltd
GPO Box 456
Brisbane Qld 4001

Dear Ms Bains

Approval—Meteor Downs South Pricing DAAU

The Queensland Competition Authority (QCA) approved Aurizon Network's Meteor Downs South pricing draft amending access undertaking (the MDS Pricing DAAU) on 17 December 2020. The attached decision notice sets out the basis for this decision.

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

Should your staff have any specific queries on the attached paper, please direct them in the first instance to Pag Arao-Arao on 3222 0560, or by email pag.arao-arao@qca.org.au. Otherwise, I am happy to discuss any questions you may have on this or any other matters.

Yours sincerely



Charles Millstead
Chief Executive Officer

cc: *Peter Long, Head of Finance and Regulation Network, Aurizon Network*

DECISION NOTICE

AURIZON NETWORK'S METEOR DOWNS SOUTH PRICING DAAU—DECISION

17 DECEMBER 2020

The Queensland Competition Authority approved Aurizon Network's MDS Pricing DAAU, under section 142(2) of the *Queensland Competition Authority Act 1997*.

Background

Sojitz Coal Mining (Sojitz) has entered into an access agreement with Aurizon Network for a term of 10 years. Aurizon Network said that the Starlee passing loop (Starlee expansion) on the Bauhinia branch line provides a prudent and efficient option to meet the required additional volumes to accommodate the access rights Sojitz has sought.^{1 2}

Aurizon Network is seeking to implement a pricing proposal for the Starlee expansion using some, but not all, of the elements of the expansion pricing framework in the 2017 access undertaking (UT5).

The Meteor Downs South (MDS) pricing DAAU (MDS pricing DAAU) seeks to give effect to the Starlee expansion pricing proposal.³ This includes amending schedule F of UT5 to introduce an expansion tariff, separate the MDS and Blackwater system volume forecasts⁴, and revise the allowable revenue; amending cl. 6.4.6 to set out an end date for the MDS expansion tariff; and amending the definition of private incremental costs (PIC). Aurizon Network has also sought the QCA's approval of access conditions between Aurizon Network and Sojitz in accordance with cl. 6.13.2 of UT5.⁵

¹ Aurizon Network, *Meteor Downs South Pricing Draft Amending Access Undertaking*, supporting submission, August 2020, pp. 6–7.

² The project also requires the construction of a privately owned rail loop and the associated Aurizon Network-owned and user-funded connecting infrastructure.

³ On 6 August 2020, Aurizon Network submitted the MDS pricing DAAU and supporting documentation. On 28 October 2020, Aurizon Network proposed consequential amendments that were consistent with its initial proposal but better reflected its intent.

⁴ This includes updated system forecasts provided with Aurizon Network's original submission (cl. 7 of schedule F), as well as additional amendments to the monthly system forecasts for 2001 undertaking access agreements that were subsequently provided (cl. 12 of schedule F).

⁵ Aurizon Network, supporting submission, pp. 30–31, Attachment C (redacted).

On 19 November 2020, we accepted, in principle, key aspects of the MDS pricing DAAU, setting out our preliminary views on the issues raised.

Statutory obligations

Under the *Queensland Competition Authority Act 1997* (QCA Act), Aurizon Network can submit a voluntary DAAU to amend the approved access undertaking (s. 142(1)).

We must consider the DAAU and either approve, or refuse to approve, the DAAU (s. 142(2)), having regard to the matters mentioned in s. 138(2), and the conditions set out in the QCA Act, including that the DAAU has been published and submissions have been sought and considered (s. 143).

Stakeholders' response

Aurizon Network included confirmation of Sojitz' support for the key terms of the MDS pricing DAAU in its supporting documentation.⁶

We provided stakeholders with an opportunity to comment on the MDS pricing DAAU and received one submission, from the Association of Mining and Exploration Companies (AMEC), which supported the proposal.

We also published and sought comments on our preliminary view. We received no submissions in response.

Extending the UT5 expansion framework

Aurizon Network sought to develop a pricing proposal for the Starlee expansion under the UT5 expansion pricing provisions as a consensus expansion that fully socialised the expansion costs and volume risks.⁷ However, the proposal failed to achieve consensus among expansion stakeholders, with the key concern being the potential for non-expanding users to bear short- and medium-term volume risk.⁸

While UT5 provides for Aurizon Network to submit a pricing proposal as an endorsed expansion to the QCA for approval in that event⁹, Aurizon Network has instead submitted the MDS pricing DAAU.

Aurizon Network said that the pricing proposal:

- is largely aligned with the UT5 expansion pricing principles and is consistent with the factors set out in s. 138(2) of the QCA Act.¹⁰ This includes appropriately balancing the costs and risks of the Starlee expansion with the benefits to the expanding users, non-expanding users and Aurizon Network as the access provider
- departs from the UT5 expansion pricing principles where necessary, to address unintended outcomes of existing provisions and properly take account of the particular circumstances of the Starlee expansion (being for a single mine with a long haulage distance, rather than a larger multi-user expansion)¹¹
- addresses concerns raised by some stakeholders during consultation on an earlier pricing proposal that was being progressed under the UT5 expansion provisions.¹² This includes better aligning the annual revenue

⁶ Aurizon Network, supporting submission, Attachment B.

⁷ Aurizon Network, supporting submission, pp. 9–10, Attachment A.

⁸ Aurizon Network, supporting submission, pp. 10, 17.

⁹ In the form of an application for a ruling under division 7A of Part 5 of the QCA Act.

¹⁰ Aurizon Network, supporting submission, pp. 20–24.

¹¹ Aurizon Network, supporting submission, pp. 12–14.

¹² Aurizon Network, supporting submission, pp. 17–18.

requirement of the expansion costs and incremental costs to the annual revenue from the expansion tariff and reducing the term for which the expansion tariff will apply.¹³

Aurizon Network said that the MDS pricing DAAU expedites the establishment of the expansion tariff, as it allows for the approval of the pricing proposal and the expansion tariff to occur concurrently.¹⁴ It noted that its proposal contains all of the components and supporting information that would have been required under the UT5 expansion framework.¹⁵

While Aurizon Network said it has also identified other possible opportunities that it considered could improve the efficacy of the UT5 expansion framework, it has not proposed amendments at this time. Instead, Aurizon Network said it would consult and negotiate with stakeholders on this over the term of UT5.¹⁶

Pricing approach for the Starlee expansion

Aurizon Network sought to treat the Starlee expansion like an endorsed expansion, where the calculation of the expansion tariff is set out in cl. 6.4.5(a) of UT5¹⁷. This provides for the development of an expansion tariff based on its own contract volumes, subject to an adjustment for a contribution to common costs (under cls. 6.4.5 and 6.4.6).

However, Aurizon Network departed from the common cost contribution requirements (which require a contribution to common costs such that the expansion tariff and the system tariff are equivalent on a \$/ntk basis (cl. 6.4.5(f)), because this would result in an expansion tariff that exceeds the system reference tariff on an AT1 to AT4 basis. Aurizon Network said this would not be equitable or efficient.¹⁸ Instead, Aurizon Network provided for a contribution to common costs that establishes an expansion tariff equivalent to the system reference tariff on a cost of access basis (with AT1 to AT4 tariff components being the same in both).

Aurizon Network also departed from the UT5 treatment of private incremental costs (PIC) to determine access charges (which set the PIC amounts at zero until approved by the QCA (cl. 6.3.2(e)(ii)). Aurizon Network has instead used a notional estimate of the PIC amounts (with any adjustments made to account for any difference between the notional and approved PIC, once approved). Aurizon Network also included the value of the connecting infrastructure, owned by Aurizon Network and funded by the access seeker, in calculating the PIC value.¹⁹

The expansion tariff applies from 1 July 2020 to 30 June 2022. After that, the MDS mine would be subject to the system reference tariff and on the same terms and conditions as an access seeker seeking new or additional rights that did not require an expansion.

We consider that this pricing approach is appropriate. The MDS pricing DAAU builds on the earlier approach by seeking to address stakeholder concerns, while providing an opportunity for consultation on the new proposal, as well as assessment against defined criteria in s. 138(2) of the QCA Act.

¹³ Aurizon Network, supporting submission, p. 12.

¹⁴ Aurizon Network, supporting submission, p. 11.

¹⁵ Aurizon Network, supporting submission, p. 11. This includes setting out the proposed allocation of costs and risks and corresponding reference tariffs and explaining how the pricing proposal is consistent with the UT5 expansion pricing principles.

¹⁶ Aurizon Network, supporting submission, p. 4.

¹⁷ Aurizon Network, supporting submission, p. 10.

¹⁸ Aurizon Network, supporting submission, p. 13.

¹⁹ Aurizon Network, supporting submission, p. 14.

While elements of the proposed pricing approach are different to what had been envisaged in the UT5 expansion framework, we consider it is appropriate in this instance. We consider that the proposed approach offers a pragmatic solution, which takes advantage of the UT5 expansion framework principles but also has regard to the particular circumstances of the Starlee expansion. It also appears to address stakeholders' previous concerns around the costs and risks associated with the MDS project.

Proposed allowable revenues and reference tariffs

Aurizon Network has proposed to amend the Blackwater system reference tariff to provide for an expansion tariff for MDS. This includes nominating MDS as a loading facility, providing for expansion tariff forecasts and volume forecasts (and revising the system reference tariff inputs and volumes accordingly)²⁰, setting out and revising the total system allowable revenue (which includes the allowable revenue for both the system reference tariffs and the expansion tariff) and revising the system discounts.

The key assumptions Aurizon Network used in determining the expansion tariff include:

- contracted services over 10 years
- \$8.6 million for expansion costs, with accelerated depreciation (2 years rather than 10)
- a notional PIC component (rather than an approved amount), which includes the value of connecting infrastructure
- a positive contribution to common costs.

Aurizon Network said the pricing approach sought to appropriately balance the costs and risks of the expansion, with benefits to both the users of the expansion and the non-expansion users, such that:

- non-expanding users receive the full benefit of the expansion via an access charge that reflects the expansion user's contribution to common costs.²¹ Aurizon Network said that the subsequent calibration (MDS 2020–21 reference tariff volumes, pre-socialisation and post-socialisation comparison) represents the net benefit to non-expanding users (from the positive contribution to common costs included within the expansion tariff)²²
- the costs of extending the power system to the Starlee loop will not be borne by other users via the AT5 tariff (no additional costs to the AT5 electric component is added). The electrification of the loop is included in the expansion tariff component (AT2 to AT4 cost base), consistent with applied methodology in the GAPE project²³
- the volume risks identified through the timing of those benefits—which in this case are partly deferred until recovery of expansion costs via the expansion tariff²⁴—are addressed.
- the socialisation component lessens the disproportionate allocation of costs and volume risks on MDS—which would otherwise bear system volume risk while assuming full liability of its own volume risks.²⁵

²⁰ The revised AT1–AT4 tariff components for Blackwater system reference tariff and the MDS expansion tariff are the same.

²¹ Aurizon Network, supporting submission, p. 18.

²² Aurizon Network, supporting submission, pp. 19–20.

²³ Aurizon Network, supporting submission, p. 18.

²⁴ Aurizon Network, supporting submission, p. 4.

²⁵ Aurizon Network, supporting submission, p. 18.

We assessed the proposed expansion tariff and associated materials and noted that they reflect the relevant annual maximum revenues (or access charge amount) and system reference tariffs:

- applying modelling and methodology consistent with the established reference tariffs, and correctly accounting for contribution to common costs
- deducting the notional PIC components, and accounting for the associated impact on Blackwater assets.

QCA assessment and decision

Our decision is to approve Aurizon Network's MDS pricing DAAU under section 142(2) and in compliance with section 143.

We consider approving the proposed amendments is consistent with the legitimate business interests of Aurizon Network and the interests of access seekers and holders (s. 138(2)(b), (e), (h)). It also supports the efficient operation and use of Aurizon Network's infrastructure in the Central Queensland coal network (s. 138(2)(a)) and is consistent with pricing principles of Part 5 of the QCA Act (ss. 138(2)(g) and 168A). In particular:

- Aurizon Network has correctly aligned the revenue requirement related to the expansion costs and private incremental costs in its proposed expansion tariff so that costs reflect proportional risks and benefits to expansion users and non-expansion users, minimising costs borne by customers of the system, having regard to both Aurizon Network's interests and the interests of its users (ss. 138(2) (a), (b), (e), (g) and (h), 168A)
- Aurizon Network has addressed a key concern for some stakeholders who 'do not wish to bear those costs and risks' of socialisation by reducing the term for which the expansion tariff will be applicable, and by applying an accelerated depreciation approach to the expansion costs, has addressed the interests of access seekers to the service (s. 138(2)(e), (h))
- the proposed amendments provide for the termination of an expansion tariff (cl. 6.4.6) and include the value of connecting infrastructure, owned by Aurizon Network and funded by the access seeker, in the PIC value (definitions, cl. 12.1), thereby providing greater clarity over the treatment of these matters. This gives due consideration to both Aurizon Network's interests and the interests of its users (s. 138(2) (b), (e) and (h)).

Our decision is to approve the amendments set out in Aurizon Network's MDS pricing DAAU proposal of 6 August 2020 and 28 October 2020. It has been made following, and on the basis of, our approval of the Maintenance and Cross System Voting DAAU.²⁶

²⁶ Queensland Competition Authority, *Maintenance and Cross System Voting DAAU*, final decision, October 2020.