

Queensland Competition Authority

File Ref: 550399

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Mr Michael Carter
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Dear ~~Mr Carter~~ *Mike*

Final Approval: Draft Amending Access Undertaking to extend the term of the 2010 access undertaking

The Queensland Competition Authority (the Authority) today issued its final decision to approve Aurizon Network's Draft Amending Access Undertaking to extend the term of the 2010 access undertaking (the 2010 Extension DAAU(May)).

Context

Aurizon Network's 2010 access undertaking is due to expire on 30 June 2013. On 30 April 2013, Aurizon Network submitted a voluntary draft access undertaking (the 2013 DAU) to replace the 2010 access undertaking.

The 2010 Extension DAAU (May) seeks to provide certainty around the process for setting access charges for the 2013-14 year, given a replacement undertaking will not be in place by 1 July 2013.

On 9 May 2013, the Authority received Aurizon Network's 2010 Extension DAAU (May) proposing to amend its 2010 access undertaking to:

- (a) extend the terminating date of the 2010 access undertaking to the earlier of 30 June 2014 or the date on which the 2010 access undertaking is withdrawn (cl. 12.1);
- (b) remove any retrospective liability created by amending the terminating date (cl. 12.4) – so that Aurizon Network is not now held responsible for failing to comply with provisions that it would not have been required to comply with should the undertaking have expired on 30 June 2013;
- (c) provide for 'transitional' System Allowable Revenues, System Forecasts and Monthly System Forecasts for 2013-14 (Schedule F, Part B, Clauses 5.3, 6.3, 7.3 and 8.3); and
- (d) provide for 'transitional' reference tariffs to apply for 2013-14 (Schedule F, Part B, Clauses 5.4(a), 6.4(a), 7.4 and 8.4).

The 2010 Extension DAAU (May) provides for transitional allowable revenues for 2013-14 of \$739 million (including the 2011-12 revenue cap) consistent with a forecast of 186 million tonnes (excluding Goonyella to Abbot Point).

Transitional reference tariffs are provided for the Blackwater, Goonyella, Moura and Newlands systems. Transitional reference tariffs are not provided for Goonyella to Abbot Point (GAPE). Instead, the existing temporary reference tariffs roll forward until approved GAPE reference tariffs, together with revised provisions establishing the GAPE system, are in place.

Aurizon Network proposed that over (or under) collections of allowable revenues for 2013-14 be recovered from (or returned to) access holders through an adjustment charge mechanism (to be finalised as part of the 2013 DAU assessment process).

Aurizon Network also foreshadowed that, in the event that it becomes unlikely that approved reference tariffs are in place for the 2014-15 year, then it will submit a further DAAU prior to June 2014 which establishes transitional reference tariffs for 2014-15. This would also provide for an adjustment charge to recover the difference between the total of the transitional allowable revenues (excluding the revenue cap) and the revenue actually collected, escalated by Aurizon Network's approved Weighted Average Cost of Capital for the 2010 access undertaking.

Stakeholder Consultation

Aurizon Network developed the 2010 Extension DAAU (May) following a period of 'close consultation' with the Queensland Resources Council (QRC).

On 14 May 2013 the Authority published the 2013 DAU on its website and invited stakeholders to comment. In response, the Authority received five submissions, from Asciano, Aurizon Holdings, BHP Billiton Mitsubishi Alliance (BMA), the QRC and Vale. In general, interested parties accepted the need for the extension, however, only BMA, the QRC and Vale supported the proposal in its entirety. Aurizon Holdings was concerned that the proposal did not include a robust estimate of volume forecasts. It also argued that it was unclear how take-or-pay would be treated as part of the 2013 DAU assessment or under any subsequent DAAUs. Asciano was concerned at the 'limited level' of information Aurizon Network provided to support its claim.

Stakeholders also raised concerns about Aurizon Network's approach more broadly. While BMA and the QRC noted that Aurizon Network had sought to respond to coal producers' concerns, Asciano highlighted the importance of Aurizon Network seeking input from all stakeholders to ensure a transparent and cohesive supply chain.

The Authority's Approach

In considering this issue, the Authority has had regard to the assessment criteria contained in section 138 of the *Queensland Competition Authority Act 1997* (the QCA Act), the information provided by Aurizon Network supporting its proposal, and stakeholders' comments in response.

In doing so, the Authority paid particular attention to whether the proposed amendments:

- (a) appropriately balances Aurizon Network's, end users' and train operators' interests (s. 138(2)(b), (c) & (e)) by, among other things seeking to ensure that the transitional tariffs:
 - (i) reflect, to the extent possible, a reasonable estimate of the tariffs that are ultimately approved as part of the 2013 DAU assessment process;
 - (ii) will recoup the revenues proposed (depending on volumes railed);
 - (iii) have been based on reasonable system forecasts (Attachment 1);

- (iv) do not unintentionally (dis)advantage particular stakeholders (and in particular those not party to the discussions between Aurizon Network and the Queensland Resources Council);
- (b) are consistent with the pricing principles in section 168A of the QCA Act (s. 138(2)(g)); and
- (c) provide certainty to all parties for access charges for 2013-14 (s. 138(2)(h)).

In addition, the Authority notes that:

- (a) Aurizon Network's rail services are currently not subject to an access code;
- (b) the Authority has not made any ruling relating to Aurizon Network's rail services;
- (c) a public consultation process has been conducted, with five submissions received; and
- (d) the Authority has taken into consideration all submissions provided by interested parties.

The Authority also notes that the proposed extension is consistent with its current views on the time required for the Authority to finalise the 2013 DAU assessment process.

Having had regard to all the factors it is required to consider, the Authority has approved the 2010 Extension DAAU (May).

In doing so, the Authority has formed the view that the proposed reference tariff components are reasonable, as it is evident that they seek to balance the interests of Aurizon Network, train operators and end users. In particular, the Authority notes that the proposed tariffs are temporary in nature and they will be superseded by the tariffs that emerge from the full consideration of the 2013 DAU.

In this context, the Authority has not formed a view about the underlying principles, the inputs used to derive the parameters or the modelling approach adopted to derive the proposed 2013-14 tariffs – these are matters better left to be resolved through the 2013 DAU assessment process. On that basis, the Authority reserves the right to consider these matters on their merits, in accordance with the relevant provisions of the QCA Act, as part of the 2013 DAU assessment process.

Nevertheless, the Authority has paid particular attention to the volume forecasts and, in doing so, considers that it has taken into account Aurizon Holdings' concerns around the process of 'rolling forward' volume forecasts.

The Authority engaged Energy Economics to review the forecast volumes for 2013-14. The volume forecasts included in the 2010 Extension DAAU (May) are not dissimilar to those provided by Energy Economics, in particular:

- (a) Energy Economics' estimated forecast volumes for 2013-14, of 186.8 million tonnes (excluding GAPE traffic), is well within the potential range of forecasting error of Aurizon Network's proposal of 186.0 million tonnes (0.4% net difference); and
- (b) while there is greater variability between Aurizon Network's and Energy Economics' volume forecasts at the system level, this is not unexpected as factors affecting system (or mine) volumes will be off-set by the circumstances or events in other systems (or mines).

The Authority also notes that the QRC considers that the volume forecasts are 'reasonable' and added that strong railings are being recorded in all systems following recovery from the flood impacts of early 2013 (and are expected to continue).

Stakeholders have also raised concerns on a number of matters that are beyond the scope of the 2010 Extension DAAU (May). This includes Aurizon Network's approach to both the 2010 Extension DAAU (May) and to the 2013 DAU and other regulatory processes.

The Authority notes that, in making this decision, it has not sought to judge how Aurizon Network has chosen to engage with its stakeholders in developing its proposal. This is a matter for Aurizon Network and the stakeholders. That said, it would appear to make some sense for Aurizon Network to work with all of its stakeholders to identify emerging issues and find common ground on particular matters.

In any event, the Authority will continue to seek to engage with all stakeholders as part of its decision making processes.

The Authority also notes that Aurizon Network intends to recover (or return) the difference between the transitional revenues and the approved revenues through an adjustment charge. The Authority will deal with this matter when it is brought formally to the Authority for approval (i.e. through the 2013 DAU assessment process or, if required, a further DAAU).

Yours sincerely



Malcolm Roberts
Chairman

Attachment 1: Volume forecasts

The 2010 Extension DAAU (May) includes system forecasts for 2013-14, consistent with a forecast of 186 million tonnes (excluding the Goonyella to Abbot Point system) as approved by the Authority for 2012-13.

The Authority engaged Energy Economics to assess the reasonableness of Aurizon Network's volume forecasts, paying particular attention to:

- (a) identifying the major factors likely to impact on total network forecasts, and on individual system forecasts, including demand-side factors such as growth forecasts in major coal importing countries and downstream importers of manufactured goods, and supply-side factors such as weather and industrial disputation;
- (b) local conditions within the mines, contracted tonnages, current and future issues affecting capacity, general market conditions, any issues related to port capacity and coal reserves.

Energy Economics undertook its analysis and based its evaluation on a number of parameters, including:

- (a) an appraisal of current mine capacity and capacity expansion projects, including port capacity and charges, and rail infrastructure capacity and charges;
- (b) potential changes at the mine/company level in terms of raiing practices, changes in contractual arrangements, mine problems, new markets or contracts;
- (c) domestic and international market conditions; and
- (d) coal reserves and mining costs;

Based on its assessment, Energy Economics' forecast volume for the central Queensland coal network for 2013-14 was 186.8 million tonnes (excluding GAPE tonnages - see Table 1 for details).

Table 1: Aurizon Network and Energy Economics 2013-14 volume forecast (mtpa)^a

| System | Aurizon Network | Energy Economics | Variance (%) |
|------------|-----------------|------------------|--------------|
| Blackwater | 57.7 | 60.1 | -4.1 |
| Goonyella | 99.0 | 98.7 | 0.3 |
| Moura | 13.5 | 12.1 | 11.7 |
| Newlands | 15.8 | 15.9 | -0.4 |
| Total | 186.0 | 186.8 | -0.4 |

^a These forecasts exclude volumes on the Goonyella to Abbot Point system.

On this basis, Energy Economics concluded that Aurizon Network's 2013-14 forecast volumes were reasonable. Overall, Energy Economics expects coal market forecasts to remain weak in fiscal year 2013-14 with overcapacity and low prices prevailing throughout the year. Energy Economics attributed this weak market condition to past optimism in bringing new production capacity on stream globally, rather than a weakness in global demand for coal, with significant growth in international trade volumes expected for 2013-14, and Australia's share of that growth to be substantial, particularly if the value of the Australian dollar continues to fall.

The Authority has taken Energy Economics' findings into account in assessing the reasonableness of the 2013 Extension DAAU (May) volume forecasts. In particular, the Authority notes that:

- (a) Energy Economics' underlying assumptions seem reasonable and credible;
- (b) the data sources used by Energy Economics appear valid and supportable; and
- (c) an appropriate level of detail has been provided to support the forecasts, on a whole of network basis, for each coal system and for individual mines.

In total, Energy Economics' volume forecasts for 2013-14 are consistent with Aurizon Network's forecast. The Authority has also placed some reliance on Energy Economics' comments that:

- (a) while domestic coal demand, particularly in thermal coal is weak, over the long term, there is some expected recovery as the existing spare capacity is fully utilised;
- (b) international coal markets are currently characterised by strong growth in demand but even stronger growth in supply capacity, which suggests a stabilising effect on overall demand;
- (c) prices for both thermal and coking coal are steady and generally recovering in 2013-14, which, coupled with recent falls in the Australian dollar against the US dollar, will sustain the competitive position of coal in Queensland; and
- (d) levels of coal railings forecasts are not expected to be constrained by rail and port capacity.

The Authority notes that, while the two forecasts are equivalent for the central Queensland coal region as a whole (excluding GAPE), there is some variance at individual coal system level. The Authority considers that this is not unusual as it might be expected that factors affecting specific mine or system volumes will be off-set by the circumstances or events occurring at other mines or systems. The level of uncertainty about forecasts at the individual mine or system level is therefore necessarily greater than at the level of the network as a whole.

While these variances may have some impact on tariffs and the timing of Aurizon Network's revenue stream in the short-term, it will not ultimately affect the net present value of those revenues given the role of the revenue capping mechanism.

Given the above, the Authority has accepted that the 2010 Extension DAAU (May) system forecasts are reasonable.

Energy Economics' report has been published on the Authority's website.