

File Ref: 1432149

19 November 2020

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

Dear Ms Bains

**Meteor Downs South Pricing DAAU—preliminary position**

On 6 August 2020, Aurizon Network submitted a draft amending access undertaking (the MDS pricing DAAU), proposing to implement an expansion tariff for the new coal carrying train services operating from the Meteor Downs South mine project.

Overall, the QCA accepts, in principle, the key aspects of the MDS pricing DAAU.

The attached response to the MDS pricing DAAU provides a summary of the QCA's preliminary views on the issues raised to provide guidance to all stakeholders and build on the work already undertaken to date.

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

I am happy to discuss any question you may have on this or any other matters. Should your staff have any specific queries on the attached paper, direct these in the first instance to Pag Arao-Arao on 3222 0560 or by email [pag.arao-arao@qca.org.au](mailto:pag.arao-arao@qca.org.au)

Yours sincerely



Charles Millstead  
Chief Executive Officer

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

## QCA'S PRELIMINARY RESPONSE TO AURIZON NETWORK'S MDS PRICING DAAU

This paper provides Aurizon Network and other interested stakeholders with an insight into our preliminary views on the Meteor Downs South (MDS) pricing DAAU (MDS pricing DAAU).

### The MDS Pricing DAAU

Sojitz Coal Mining 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 access rights being sought.<sup>1 2</sup>

The Starlee expansion in the Blackwater system is expected to expand the capacity of the system while accommodating access rights sought by the MDS mining project. 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).

Aurizon Network has submitted a draft amending access undertaking (DAAU) to give effect to this pricing proposal.<sup>3</sup> This includes amending Schedule F of UT5 to introduce an expansion tariff, separate the MDS and Blackwater system volume forecasts,<sup>4</sup> 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 said that the pricing proposal:

- is largely aligned with the expansion pricing principles set out in cl. 6.4 of the 2017 access undertaking (UT5) and is consistent with the factors set out in s. 138(2) of the QCA Act.<sup>5</sup> 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 a single mine with a long haulage distance, rather than a larger multi-user expansion)<sup>6</sup>
- addresses concerns raised by some stakeholders during earlier consultation on an earlier pricing proposal that was being progressed under the UT5 expansion provisions.<sup>7</sup> This includes better aligning the annual revenue 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.<sup>8</sup>

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<sup>1</sup> Aurizon Network, *Meteor Downs South Pricing Draft Amending Access Undertaking*, August 2020, pp. 6–7 (supporting submission).

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

<sup>3</sup> Aurizon Network, supporting submission, p. 4.

<sup>4</sup> 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).

<sup>5</sup> Aurizon Network, supporting submission, pp. 20–24.

<sup>6</sup> Aurizon Network, supporting submission, pp. 12–14.

<sup>7</sup> Aurizon Network, supporting submission, pp. 17–18.

<sup>8</sup> Aurizon Network, supporting submission, p. 12.

While Aurizon Network also identified other possible opportunities that it considered could improve the efficacy of the UT5 expansion pricing framework, it has not proposed amendments as part of the MDS pricing DAAU. Instead, Aurizon Network said it would consult and negotiate with stakeholders on this over the term of UT5.<sup>9</sup>

## 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) (s. 143(2)).

As required under s. 143 of the QCA Act, we have published this DAAU, sought submissions, and considered the DAAU having regard to the matters mentioned in s.138(2) of the QCA Act.

In this instance, we have chosen to share with stakeholders our preliminary views on the proposal, given some key concerns Aurizon Network has documented in seeking initial consensus. We consider the interests of all stakeholders will be served by conferring matters under review, and consulting on our views on the substantive parts of Aurizon Network's proposal.

This paper provides our preliminary view and is intended to give stakeholders an insight into that view before we finalise our position.<sup>10</sup> Our application of statutory assessment criteria and our thinking may change in response to any submissions made in response to this paper.

## Stakeholders' response

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.<sup>11</sup>

## Preliminary view

We are minded to approve the MDS pricing DAAU in accordance with ss. 142 and 143 of the QCA Act, having regard to the relevant statutory criteria and following consideration of the AMEC's submission in support.

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).

## Extending the UT5 expansion framework

Aurizon Network had 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.<sup>12</sup> However,

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<sup>9</sup> Aurizon Network, supporting submission, p. 4.

<sup>10</sup> This is not a draft version of a final decision, and it has no force of itself. There should be no expectation that it presents views and recommendations which will prevail to the end of the decision-making process.

<sup>11</sup> While this information has been provided after the stated deadline for submissions, we took this into account in accordance with the QCA Act.

<sup>12</sup> Aurizon Network, supporting submission, pp. 9–10, Attachment A.

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.<sup>13</sup>

While UT5 provides for Aurizon Network to submit a pricing proposal as an endorsed expansion to the QCA for approval in that event,<sup>14</sup> Aurizon Network has instead submitted the MDS pricing DAAU.

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.<sup>15</sup> It also noted that the MDS pricing DAAU is based on the key principles of the UT5 expansion framework expansions (tailored for the characteristics of this expansion) and contains all of the components and supporting information that would have been required under the UT5 framework.<sup>16</sup>

#### Pricing approach for the Starlee expansion

Aurizon Network has 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 UT5<sup>17</sup>. 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 has 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 \$ per ntk basis (cl. 6.4.5(f)), because this would result in an expansion tariff which exceeds the system reference tariff on an AT1 to AT4 basis. Aurizon Network said this would not be equitable or efficient.<sup>18</sup> 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 has 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)) and 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.<sup>19</sup>

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.

In this instance, 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 s. 138(2) of the QCA Act.

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<sup>13</sup> Aurizon Network, supporting submission, pp. 10, 17.

<sup>14</sup> In the form of an application for a ruling under division 7A of Part 5 of the QCA Act.

<sup>15</sup> Aurizon Network, supporting submission, p. 11.

<sup>16</sup> 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.

<sup>17</sup> Aurizon Network, supporting submission, p. 10

<sup>18</sup> Aurizon Network, supporting submission, p. 13.

<sup>19</sup> Aurizon Network, supporting submission, p. 14.

While elements of the pricing approach adopted are different to what had been envisaged in the UT5 expansion framework, we consider this 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 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),<sup>20</sup> 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.

In determining the expansion tariff, Aurizon Network provided key assumptions in support including:

- 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 seeks to appropriately balance the costs and risks of the expansion, with benefits to both the users of the expansion and non-expansion users, such that:

- non-expanding users receive the full benefit of the expansion via an access charge reflecting the expansion user's contribution to common costs.<sup>21</sup> Aurizon Network said that the subsequent calibration (MDS 2020–21 reference tariffs 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)<sup>22</sup>
- 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–AT4 cost base), consistent with applied methodology in the GAPE project<sup>23</sup>
- the volume risks identified via the timing of those benefits – which in this case, is partly deferred until recovery of expansion costs via the expansion tariff<sup>24</sup> – is addressed.
- the socialisation component lessens the disproportionate allocation of costs and volume risks on MDS—both system volume risk and assuming full liability of its own volume risks.<sup>25</sup>

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

<sup>21</sup> Aurizon Network, supporting submission, p. 18.

<sup>22</sup> Aurizon Network, supporting submission, pp. 19–20.

<sup>23</sup> Aurizon Network, supporting submission, p. 18.

<sup>24</sup> Aurizon Network, supporting submission, p. 4.

<sup>25</sup> Aurizon Network, supporting submission, p. 18.

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

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

We consider that 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 and has addressed the interests of access seekers to the service (s. 138(2)(e)).

Additionally, we consider that Aurizon Network has correctly aligned the revenue requirement (s. 138(2)(g)), 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, giving regard to both Aurizon Network's interest and the interest of its users (s. 138(2) (b), (c) and (e)).

We also accept that the proposed amendments to provide for the termination of an expansion tariff (cl. 6.4.6) and to include the value of connecting infrastructure, owned by Aurizon Network and funded by the access seeker, in the PIC value (definitions, cl. 12.1) provide greater clarity over the treatment of these matters.

### Way forward

Subject to stakeholder views provided in response to this preliminary position, we would be minded to approve the MDS proposal.