

File Ref: 1299162

21 June 2018

Mr Nick Easy
Chief Executive Officer
Queensland Rail
GPO Box 1429
Brisbane Qld 4001

Dear Mr Easy

Draft decision to approve New Hope Review Event

On 21 June 2018, the Queensland Competition Authority made a draft decision to approve varying the West Moreton reference tariff to reflect the New Hope review event of 1 July 2018, as per Queensland Rail's application on the 9 April 2018.

The attached decision notice provides a summary of the QCA's preliminary assessment of the review event.

If you have any questions about this decision notice, please contact Stephen Wisenthal at (07) 3222 0507 or stephen.wisenthal@qca.org.au.

Yours sincerely <



Charles Millstead
Chief Executive Officer

DRAFT DECISION NOTICE

QUEENSLAND RAIL'S APPLICATION: NEW HOPE REVIEW EVENT 1 JULY 2018

21 June 2018

The Queensland Competition Authority has made a draft decision to approve a variation of the West Moreton reference tariff resulting from the New Hope Review Event of 1 July 2018.

Queensland Rail's application

On 9 April 2018 Queensland Rail applied to increase the West Moreton reference tariffs to reflect a pending reduction in the number of contracted train paths from New Hope's New Acland mine.

The QCA is assessing the review event application in accordance with Schedule D, clause 5 of the 2016 Access Undertaking (2016 AU).

The reduction in train paths is expected to increase the West Moreton two part tariff (in 2016–17 dollars) as at 1 July 2018 as follows:

- AT1: from \$7.95/'000 gross tonne kilometres (gtk) to \$8.31/'000 gtk (\$0.37/'000 gtk) (4.64%)
- AT2: from \$2,791.20/train path to \$2,965.51/train path (\$174.31/train path) (6.25%)¹

Context

This is the first time Queensland Rail has made a review event application under the 2016 AU. A review event is defined as:

- (a) a material change in circumstances, other than a change to a Network Capacity Constraint, that Queensland Rail can reasonably demonstrate may give rise to a need to vary the relevant Reference Tariff; and
 - (i) in respect of which Queensland Rail has given written notice to the QCA of Queensland Rail's intention to propose a variation to that Reference Tariff under clause 5 of schedule D;

In assessing whether a review event has occurred and can be approved, the QCA must consider whether it is appropriate with regard to the criteria in section 138(2) of the QCA Act. These criteria include promoting economically efficient operation of, use of and investment in regulated infrastructure, with the effect of promoting

¹ Tariffs are escalated annually using actual CPI (see Schedule D, cl. 3.3(a)).

competition in related markets. They also encompass the legitimate business interests of Queensland Rail, the interests of access seekers and access holders, and more broadly, the public interest.

The QCA's June 2016 decision on Queensland Rail's 2015 draft access undertaking (the June 2016 decision) contemplated that a review event might occur during the term of the undertaking, saying:

The QCA requires Queensland Rail to amend the process for varying reference tariffs in relation to review events to explicitly state that, in considering such proposed variations, the QCA will have regard to the approval criteria in section 138(2) of the QCA Act.²

The final decision said not doing so:

would have the potential to prejudice the efficient use of and investment in rail infrastructure; the interests of Queensland Rail, its access seekers and holders, and their customer; and the public interest.³

Pricing framework

The QCA designed a pricing framework for coal services on the West Moreton system with the intent of balancing the interests of access holders and seekers with the legitimate business interests of Queensland Rail. Access holders and seekers may benefit from lower tariffs and higher train path availability whereas Queensland Rail may benefit from higher tariffs and recovering its efficient costs (i.e. the costs of operating, maintaining and recouping sunk investments in its rail infrastructure). In the June 2016 decision the QCA sought to balance these competing objectives by designing a pricing regime that would:

- provide appropriate tariffs to access holders and seekers
- allow Queensland Rail to recover its efficient costs
- reduce the risk to Queensland Rail by encouraging its customers to contract for access rather than use ad hoc services
- encourage Queensland Rail to provide below-rail capacity.

Queensland Rail's West Moreton system is regulated under a price cap regime. The price cap operates in conjunction with a capped take-or-pay mechanism whereby Queensland Rail can earn take-or-pay revenue on contracted paths up to an approved amount, known as the approved ceiling revenue limit.

The price cap was determined by dividing Queensland Rail's efficient costs plus an appropriate regulatory return by volume forecasts which included both contracted paths and ad hoc paths. The tariff is then levied on a two-part basis in the form of:

- a haulage charge levied on volume of coal transported across the network as measured by gross tonne kilometres (GTK's) in \$/'000 GTK
- a capacity charge levied on the number of train paths being used by access holders in \$/train path

The effect of this approach is to:

- reduce the price that access holders and seekers would pay, below what would apply if only contracted paths were considered.
- encourage Queensland Rail to contract more paths with access holders that would be subject to take-or-pay.
- encourage Queensland Rail to offer more ad hoc paths to earn revenue above its approved ceiling revenue limit.

² QCA, Queensland Rail Draft Access Undertaking 2015, final decision, June 2016, p. 177

³ QCA, Queensland Rail Draft Access Undertaking 2015, final decision, June 2016, p. 177

The pricing regime limits Queensland Rail's exposure to risk, but enables it to earn revenues in excess of the amount approved, where favourable economic conditions are present.

In the event that contracted volumes exceed the volume forecasts, a tariff variation, known as an endorsed variation event, was introduced to encourage more efficient use of the West Moreton network and deliver value to access holders and seekers.

Stakeholder comments

The QCA received one submission, from New Hope Group, which said:

- Queensland Rail's application did not represent a material change in circumstances and did not constitute a review event
- the change in contracted paths was not material in the context of Queensland Rail's revenue
- Queensland Rail's application introduced price uncertainty which could negatively impact on investment in coal mines, demand for mining contracts and future demand for coal handling services.⁴

QCA analysis

In determining whether to approve or refuse to approve Queensland Rail's application, the QCA assessed whether a review event had occurred and whether approving a resulting tariff variation would meet the criteria of section 138(2).

Review event

A review event is considered a material change in circumstances that is not the result of a network constraint and that gives rise to a need to vary the reference tariff.⁵

The QCA considers that the renegotiation of a lower level of contracted paths with New Hope is a material change in circumstances. The QCA considers that a review event will occur as the actual number of contracted paths for New Hope from 1 July 2018 will be lower than the number of contracted paths used to set the pricing in the 2016 AU.

The QCA has reviewed Queensland Rail's re-submitted model and confirmed that the revised tariffs have been correctly calculated (see Queensland Rail's Amended Application).

Symmetric approach

In determining whether to approve Queensland Rail's review event the QCA has assessed the application against section 138(2) of the QCA Act.

In the June 2016 decision, the QCA adopted an approach to pricing which sought to balance competing objectives between access holders, seekers and Queensland Rail. It said:

We have developed a form of regulation and pricing structure, including a take-or-pay regime that, among other things, promotes economic efficiency and the public interest, and provides incentives for investment. In doing so, it allocates risk to the parties best able to manage them.⁶

In assessing the tariffs proposed in Queensland Rail's 2015 DAU, the QCA accepted Queensland Rail's volume forecasts. These volumes included both contracted paths, and ad hoc paths forecast based on past railings.

⁴ New Hope Group, sub. 1, pp. 1–4

⁵ Queensland Rail, Queensland Rail's Access Undertaking 2016 (UT1), approved October 2016, p.81

⁶ QCA, Queensland Rail Draft Access Undertaking 2015, final decision, June 2016, p. 164

Queensland Rail retained exposure to higher revenue if actual railings were above the forecast, but also to a revenue shortfall, if ad hoc railings were less than expected.

The QCA considers this tariff approach balances the interests of Queensland Rail and its customers. The endorsed variation event mechanism requires Queensland Rail to reduce tariffs where contracted train paths exceed the volume forecasts used to calculate the approved prices. This reflects the reduced risk for Queensland Rail when access holders contract for access, rather than using ad hoc services.

There is no provision in the undertaking that provides specifically for an opposite effect, whereby the increased risk from lower contracted volumes is reflected in a higher tariff. However, Queensland Rail has sought to achieve this through its review event application submitted in April 2018.

We consider it is appropriate, and symmetric, for Queensland Rail to make such a proposal. Just as higher contracted volumes reduce its risk, lower contracted volumes increase the risk it bears, as it has a lower level of guaranteed revenue (i.e. take-or-pay).

To do otherwise would create an incentive for access holders to under-contract with Queensland Rail and speculate on the availability of ad hoc paths, thereby avoiding take-or-pay exposure. This does not promote efficient use of rail infrastructure as access holders have an incentive to understate expected demand for the service. Further, Queensland Rail may face increased risk in recovering its efficient costs, reducing its incentive for long term investment and potentially encouraging it to reduce maintenance activity to save costs.

While we have kept the reduction in contracted paths confidential, we consider that it is material to Queensland Rail's expected cashflows, and therefore its risk profile.

A symmetric approach would encourage consistent access holder behaviour in that there is always an incentive to contract for paths they reasonably expect to use, as they will benefit from lower prices.

The QCA considers that the tariff variation arising from the review event is likely to:

- give Queensland Rail greater certainty it will recover more of its efficient costs, which promotes its legitimate business interest and has regard to the pricing principles (s. 138(2)(b),(g))
- encourage access holders and seekers to increase contracted paths to reduce the tariff, in line with expected demand, providing certainty and promoting efficient pricing which is in the public interest (s.138(2)(d))
- promote the efficient use of, operation of and investment in rail infrastructure (s.138(2)(a)) by:
 - encouraging access holders who efficiently use rail infrastructure to reflect this behaviour in their contracting rather than risk under-contracting and being exposed to ad hoc path availability
 - encouraging Queensland Rail to efficiently invest in and operate rail infrastructure as it receives sufficient revenue for the investment risk

Decision

The QCA has assessed the review event application against the matters set out in Schedule D, clause 5.4(a)(ii) and considers that the application is consistent with the undertaking. In particular:

- the event has occurred
- the reference tariff is calculated as if all reference tariffs have been recalculated; and
- the proposed tariff reflects the cost impact on Queensland Rail
- the proposed variation is appropriate to approve with regard to the criteria set out in section 138(2) of the QCA Act

For the reasons set out above, the QCA has made a draft decision to approve this proposed review event tariff variation.

Stakeholder comments invited

We invite stakeholders to submit comments on the QCA's draft decision by 6 July 2018.

SUBMISSIONS

Closing date for submissions: 6 July 2018

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of New Hope Review Event of July 2018. The QCA will take account of all submissions received within the stated timeframes

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority
GPO Box 2257
Brisbane Q 4001

Tel (07) 3222 0582

Fax (07) 3222 0599

www.qca.org.au/submissions

Confidentiality

In the interests of transparency and to promote informed discussion and consultation, the QCA intends to make all submissions publicly available. However, if a person making a submission believes that information in the submission is confidential, that person should claim confidentiality in respect of the document (or the relevant part of the document) at the time the submission is given to the QCA and state the basis for the confidentiality claim.

The assessment of confidentiality claims will be made by the QCA in accordance with the *Queensland Competition Authority Act 1997*, including an assessment of whether disclosure of the information would damage the person's commercial activities and considerations of the public interest.

Claims for confidentiality should be clearly noted on the front page of the submission. The relevant sections of the submission should also be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two versions of the submission (i.e. a complete version and another excising confidential information) could be provided.

A confidentiality claim template is available on request. We encourage stakeholders to use this template when making confidentiality claims. The confidentiality claim template provides guidance on the type of information that would assist our assessment of claims for confidentiality.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office, or on the website at www.qca.org.au. If you experience any difficulty gaining access to documents, please contact us on (07) 3222 0555.