



Level 15  
40 Creek Street  
Brisbane Qld 4000

PO Box 10630  
Adelaide Street  
Brisbane Qld 4000

T +61 7 3002 2900  
F +61 7 3002 2999

09 April 2020

Mr George Passmore  
**Queensland Competition Authority**  
GPO Box 2257  
Brisbane Queensland 4001

Submitted via QCA's online submissions portal

Dear Mr Passmore

**Aurizon Network annual review of reference tariffs FY2022 - allocation of Newland Shared Rail Corridor Renewals expenditure between Newland and GAPE Services**

The QCoal Group (**QCoal**) welcomes the opportunity to make a submission on Aurizon Network's (**Aurizon**) FY22 annual reference tariff review (**Tariff Submission**). This submission addresses matters in the Tariff Submission associated with Aurizon's proposed approach to allocating the Newlands FY22 rail corridor renewals expenditure.

QCoal submits that the cost of on-going renewals expenditure associated with assets within the Newlands corridor should be shared between the users of those assets, i.e between both Newlands and GAPE Users and that these costs should therefore be reflected in both the relevant reference tariffs.

It should be noted that the matter of the allocation of renewals costs in the Newlands System was the subject of QCoal's submission on Aurizon's FY2021 annual review of reference tariffs dated 9 April 2020.

Despite some recent engagement, Aurizon has failed to provide any meaningful information on incremental renewals costs in the Newlands system due to GAPE traffic. The matters associated with the apportionment of the renewals costs in the Newlands System therefore remains unresolved.

**1. Aurizon's proposed allocation of Newlands corridor renewals expenditure**

Section 4.7 of the Tariff Submission sets out an extensive volume of material Aurizon purports to have relied upon in determining its apportionment of the FY22 renewals expenditure in the Newlands rail corridor. These bases are broadly grouped as follows:

- Newlands Users utilise a 26 Tonne Axle Load (TAL) network and costs to Newlands Users should reflect the stand alone cost of renewing these assets.
- Newlands Users obtain significant benefits from GAPE and the value of these should be reflected in their tariff.
- Pricing Newlands asset renewals into the Newlands Reference tariff transitions the Newlands charge from 20TAL to 26TAL costs;
- All GAPE incremental costs are accounted for in the current GAPE tariff and the cost of any ongoing renewal of these assets are not incremental costs.

- The allocation better reflects economically efficient pricing and is consistent with the QCA's 2013 Commercial Pricing Principles (**Pricing Principles**)<sup>1</sup>; and
- The pricing provides incentives to maintain and increase utilisation of the Newlands corridor at expiry of GAPE contractual arrangements.

Each of these bases is addressed below.

## 2. Newlands Users use of 26 TAL network

Prior to the GAPE project the Newlands system operated with consists with a maximum 20 tonne axle load. The closing RAB value of the system in FY 2010-2011 was \$164,614,000. At that time the Newlands system had a nameplate capacity of 19 Mt operated well on a run-when-ready basis, had a Below Rail Transit Time (BRTT) of 124% and delivered Newlands user's coal effectively and efficiently.

During the development of the GAPE Project Aurizon determined and GAPE users agreed that the project costs were to be minimised and a key plank in achieving this was that the Aurizon team *"focussed on rolling stock configuration and operational parameters"*.

To that end:

- *"Train length and axle load were selected on the basis of existing Newlands system configuration and the capital costs required to upgrade the system to accommodate longer and heavier trains; and "*
- *"the selected H82 train consist met the objective of minimising initial project costs".*<sup>2</sup>

To achieve operation of H82 consists, there would need to be:

- *Infrastructure upgrades, track renewal works and particular duplication of the Newlands system were necessary to support additional GAPE and NAPE Volumes"*

Aurizon's 2013 GAPE DAAU and other contemporaneous user documentation state that works in the Newlands system to enable longer heavier consists, i.e a 26TAL system, were required for the GAPE Project and were not driven by any need or requirement to service the existing Newlands Users who, in fact had no input into the decision to upgrade the system.

In the Tariff Submission Aurizon states the upgrading to a 26 TAL services is

*"a factor that is relevant in the context of assessing whether Aurizon Networks proposed access charges for Newlands and GAPE Trains service comply with the pricing principles".*<sup>3</sup>

QCoal submits that the circumstances of the upgrade to a 26TAL service are also relevant. The 26TAL upgrades undertaken for and by GAPE Users were not required for the continuation of Newlands services. This is particularly relevant when assessing the Newlands Stand Alone Costs. This is also relevant in the assessment of GAPE incremental costs associated with renewal of the Newlands system which:

- was neither needed or consented to by Newlands Users, and
- is shared with and was built for other users.

<sup>1</sup> Queensland Competition Authority, statement of Regulatory Pricing Principles, August 2013, [https://www.qca.org.au/wp-content/uploads/2019/05/1918\\_X-QCA-Paper-PricingPaperFinalPosition-0813-1.pdf](https://www.qca.org.au/wp-content/uploads/2019/05/1918_X-QCA-Paper-PricingPaperFinalPosition-0813-1.pdf)

<sup>2</sup> QR Network Access Undertaking (2010) Draft Amending Access Undertaking, reference Tariff for the GAPE System, 5 September 2012, QR National Pty Limited, page 7

<sup>3</sup> Aurizon Network 2017 Access Undertaking, Annual Review of Reference Tariffs FY2022, page 22



### 3. Benefits of 26TAL to Newlands Users

The Tariff Submission refers to the “significant indirect benefits” to Newlands Users of the GAPE Infrastructure Enhancements. It appears the benefits referred to are “improved payload productivity” and the project funded modifications to their (Newlands Users) loadouts and compensation payments.”<sup>4</sup> As well as “a material increase in competition from system interoperability”.<sup>5</sup>

Whilst the exact meaning of this phrase is not clear “improved payload productivity”, implies that increasing payload increases productivity, but as has been stated above, the then current (20TAL) system was meeting existing user’s needs and the increased payloads did not increase productivity for existing Newlands Users. In fact, productivity may have declined for Newland Users as a result of the change of operating mode and increased BRTT from 124% to 160%. Aurizon states that Newlands Users were “compensated” for the increased Below Rail Transit Time (BRTT) which was an expected consequence of the additional trains and the resulting network congestion resulting from the GAPE Project.<sup>6</sup> This is not increased productivity from a Newlands User’s perspective. As Aurizon’s 2013 GAPE DAAU<sup>7</sup> stated operational efficiency resulting from “payload productivity” would benefit above rail operators. One would expect if Newlands Users were to benefit from the improved operational efficiency of above rail operators, this would be reflected in their above rail charges, however this was not the case.

Regarding modifications to train load outs (TLO), no modifications were made to any QCoal mine TLO. The Tariff Submission indicates modifications were made to turnouts and balloon loops<sup>8</sup>, which are in fact Aurizon assets and delivered no benefit to Users.

Even if Aurizon’s assertion of ex–post benefits to Newlands Users could be substantiated, which they have not been, regulatory principles, including those set out under the UT4<sup>9</sup> and UT5<sup>10</sup> expansion principles (Clause 6.4.1), together with the WIRP DAAU<sup>11</sup> state that the allocation of costs to non-expanding Users may be justified where the expansion has clear benefits to them. Further in order to meet the fairness principle this information should be ex – ante to enable users to conduct a proper cost benefit analysis. It may be that the cost to the users outweighs any benefit and had they been asked the users may have declined to participate. Relevantly, in this case there is no evidence that Aurizon provided or even attempted to provide information to non–expanding users, including quantification of costs and benefits, of the GAPE Project to them, nor of non – expanding Newlands Users consenting to such changes, they simply had no choice. Agreeing to accept compensation for increased congestion is not consent to changes to the network, and to claim otherwise is disingenuous.

---

<sup>4</sup> *ibid*, page 23.

<sup>5</sup> *ibid*, page 21.

<sup>6</sup> QR Network submission, QR Network Access Undertaking (2010) Draft Amending Access Undertaking, reference Tariff for the GAPE System, 5 September 2012, QR National Pty Limited, page 26 (Reference train characteristics)

<sup>7</sup> *ibid*, page 7

<sup>8</sup> Queensland Competition Authority, Aurizon Network 2017 Access Undertaking, Annual Review of Reference Tariffs FY2022, Table 24, page 23

<sup>9</sup> Queensland Competition Authority Aurizon Network Amended 2014 DAAU, “The 2014 Undertaking” 7 July 2016

<sup>10</sup> Queensland Competition Authority, Aurizon Newlands “Revised UT5 DAAU “The 2017 Undertaking”.

<sup>11</sup> Queensland Competition Authority, Supplementary Draft Decision, Aurizon Network 2014, DAAU: Reference Tariffs for Wiggins Island Rail Project Trains Services, July 2015,



#### 4. Transition Newlands tariff from 20TAL to 26TAL.

One of the justifications in the Tariff Submission for the proposed allocation is that it is required to transition costs associated with a 20TAL service to a 26TAL service. This is despite the fact, as described in Section 2 above, that this 'transition' was required for GAPE purposes, not for Newlands User's purposes.

QCoal has sought from Aurizon, through the FY21 & FY22 MRSB process, information about the number/ type and value of remaining 20TAL assets in the Newlands system. This information has not been provided.

The information available is:

- The closing Newlands Regulated Asset Base (RAB) in FY 2010-2011 was \$164 Million.<sup>12</sup>
- Between FY14, (post completion of the GAPE project in 2012), and FY 2021 there has been a total of \$111 Million capital expenditure in the Newlands system.<sup>13</sup>, and a further \$25 Million is forecast for FY22. Of this expenditure, Aurizon has advised approximately \$0.5M has been expended on renewals of "GAPE Infrastructure Enhancements". These costs have been included in the Newlands tariff whilst the benefits of these upgrades have been shared with GAPE Users.
- A total of \$82.2 Million was expended on upgrading existing track, formation and Ballast and rerailling to support a 26TAL system during the GAPE Project<sup>14</sup>.
- The renewals expenditure since FY14, including the FY22 forecast indicate that a significant portion of the Newlands corridor remained a 20TAL system post the GAPE Project and all costs associated with transitioning to a 26TAL network, required for GAPE, were not included in the GAPE Project Costs.

Although information is not available from Aurizon it is unclear how far the transition in the Newlands System to a 26TAL system has progressed. The Tariff Submission indicates that Aurizon intends that the costs of all future renewals in the Newlands corridor are to be borne by Newlands Users, irrespective of which users utilise those assets. Clearly this is contrary to accepted pricing principles.

#### 5. GAPE Incremental costs have been accounted for in the GAPE Reference Tariff.

The 2013 GAPE DAAU states:

*"new users do not pay less than the cost their incremental demand causes (and conversely that existing users do not pay more)."*<sup>15</sup>

The GAPE Access Tariff as set out in the 2013 GAPE DAAU established a unique system which although not an expansion, did display some, but not all, characteristics of an expansion. In the Tariff Submission, Aurizon stated that:

*In this regard (an asset specific approach) the GAPE Infrastructure Enhancements represented an incremental expansion of the Newlands System".*<sup>16</sup>

<sup>12</sup> QCA website- QR Network's 2010-11 Regulatory Asset Base (RAB) Roll -forward.

<sup>14</sup> Aurizon Network 2017 Access Undertaking, Annual review of Reference Tariffs – FY22, Table 24, page 23

<sup>15</sup> Queensland Competition Authority, Draft Decision, Goonyella to Abbot Point Expansion Reference Tariff – Draft Amending Access Undertaking, page 13.

<sup>16</sup> Aurizon Network 2017 Access Undertaking, Annual Review of Reference Tariffs FY2022, page 22

Expansion pricing principles are set out in clause 6.4.1 of both UT4 & UT5, states:

*“expanding Users should generally pay an Access Charge that reflects at least the full incremental costs (capital and operating) of providing additional Capacity”.<sup>17</sup>*

AU5 defined Incremental costs as:

*Those costs of providing Access, including capital (renewal and expansion) costs, that would not be incurred (including the cost of bringing expenditure forward in time) if the particular Train Service or combination of Train Services (as appropriate) did not operate, where those costs are assessed as the Efficient Costs and based on the assets reasonably required for the provision of Access.*

It is clear in the Tariff Submission that incremental costs associated with renewal of infrastructure required for the new (GAPE) services within the shared Newlands corridor have not been included in the GAPE Reference Tariff and have been included in the Newlands Reference Tariff.

It is difficult to reconcile how the nature of costs once classified as Incremental Costs by both Aurizon and the QCA can change, as Aurizon stated in the Tariff Submission:

*“Infrastructure Enhancements can no longer be considered Incremental to GAPE Train Service for the purpose of assessing the Stand-Alone Costs for Newlands System Users”<sup>18</sup>*

Aurizon continues describing what appears to be the rationale for this being:

*“While the rail infrastructure comprising the Goonyella to Newlands Connection is an incremental cost to GAPE Train Services, a significant proportion of the GAPE Infrastructure Enhancements to the Newland System (set out in Table 24) were shared costs which have been beneficial to both the existing Newlands Users and the GAPE/NAPE Users,”*

Aurizon Network’s rationale that costs previously categorised as incremental are no longer incremental because they benefit both existing Newlands and GAPE and that the GAPE Infrastructure enhancements were shared costs, have little foundation as it has not shown they were beneficial to existing Newlands Users.

To be clear, QCoal is not seeking that all costs associated with renewals in the Newlands system including the GAPE Infrastructure Enhancements (table 24) are *“solely attributable to the GAPE Train Service”<sup>19</sup>*, simply that the GAPE Tariff reflects the incremental costs of the GAPE Train Service’s use of the Newlands system.

## **6. Allocation is economically efficient and consistent with QCA’s commercial pricing principles.**

The Tariff Submission states that its approach to allocating Newlands System renewals expenditure results in economically efficient outcomes because it:

- Is consistent with clause 6.6.1 of the UT5, so far as the access charges it proposes are within the upper and lower pricing limits;

---

<sup>16</sup> *ibid*, page 23.

<sup>17</sup> Queensland Competition Authority, Aurizon Newlands “Revised UT5 DAAU “The 2017 Undertaking”.

<sup>18</sup> Aurizon Network 2017 Access Undertaking, Annual Review of Reference Tariffs FY2022, page 23

<sup>18</sup> *ibid*, page 23

<sup>19</sup> *Ibid*, page 24



- better reflects the efficiency and fairness objectives of the QCA's Statement of Regulator Pricing Principles (**QCA Pricing Principles**); and
- is consistent with the expansion principles set out in clause 6.4.1 of UT5.

Each of these elements is discussed below:

#### Consistency with clause 6.6.1

In its assessment of the two limbs of the pricing limits two factors are relevant, the GAPE Incremental costs and the Newlands Stand Alone Costs.

In Aurizon's assessment of Condition 1 to test the validity of its GAPE pricing, as discussed above the capital associated with renewals has not been included in the GAPE RAB incremental costs<sup>20</sup>. It is also unclear as to whether the "GAPE Infrastructure Enhancements for 26 TAL Services", as set out in Table 24 of the Proposal are included in the GAPE RAB as Aurizon describes these costs as "shared costs".

Condition 2, which depends upon an assessment of Stand-Alone Costs, which are defined in the UT5 as:

*"Those costs that Aurizon Network would incur if the relevant Train Service(s) was (were) the only Train Service (s) provided Access by Aurizon Network, where those costs are assessed:*

- (a) as the Efficient Costs: and*
- (b) on the basis of the assets reasonable required for the provision of Access."*

As discussed above, the GAPE Infrastructure Enhancements for 26 TAL Services, were not reasonably required for the provision of access to pre- GAPE Newlands Users. Accordingly, those "shared GAPE Infrastructure Enhancements" should not be included, or if they are to be included, then only that proportion used by Newlands Users should be included. In addition, only that proportion of the "replacement capital expenditure and improvements to the Newlands System assets which were not upgraded to 26TAL as part of the GAPE Project"<sup>21</sup> used by Newlands Users, should be included.

When these adjustments are made, it is unclear as to whether the price limit conditions have been satisfied.

In any event, consistency with pricing limits does not justify a particular allocation between different users and certainly should not override other regulatory pricing principles.

#### QCA Pricing Principles

To assess whether the Tariff Submission meets objectives of the QCA's Statement of Regulatory Pricing Principles (QCA Pricing Principles) both economic efficiency and fairness must be considered.

##### 1. Economic Efficiency.

The QCA's Pricing Principles state that economic efficiency:

*"is attained when no feasible changes in prices, production or consumption can benefit society as a whole."* and

<sup>20</sup> Aurizon Network 2017 Access Undertaking, Annual review of Reference Tariffs – FY22, Figure 1, page 26

<sup>21</sup> Ibid, page 27

*There are three types of economic efficiency, allocative, productive and dynamic.*<sup>22</sup>

Of these three types of economic efficiency that may be relevant to the Proposal, the most relevant is allocative efficiency. This is achieved when *"no changes can be made that would increase the total welfare of the community"*<sup>23</sup>.

In respect of the allocation of renewals capital expenditure in the Newlands corridor there is no evidence that Aurizon's allocation of these costs, as set out in the Tariff Submission, provides superior allocative economic efficiency compared with an allocation of these costs between GAPE and Newlands Users on the basis of their usage of and impact on the assets to be renewed.

In regard to pricing sending efficient price signals to current and future demand for the use of a shared corridor, the Pricing Principles<sup>24</sup> refer to a discussion paper by the Utilities Forum referring to elements of pricing principles used by Australian regulators including that *"prices lie on or between the upper and lower bounds of avoidable costs and stand alone costs"*, but they should also *"signal efficient economic costs of service provision by.....(ii) signalling the impact of additional usage on future investment costs"*. Clearly (and acknowledged by Aurizon) the usage of assets by GAPE Users in the shared Newlands system, has an impact on the cost and timing of renewal of those assets.

Whether renewals expenditure is recovered only from Newland Users or Newlands and GAPE Users, the cost of providing those services will be recovered by Aurizon. From a purely regulatory perspective Aurizon should be indifferent as to from which User's it recovers those costs. However, as Aurizon Network has stated in the Tariff Submission the proposed regulated tariffs are linked to the broader commercial arrangements with GAPE Users

*"establishing the GAPE Reference Tariff was to more closely align the regulatory pricing arrangements to support the contractual arrangements entered into at the time of the decision was made to invest in those Infrastructure Enhancements"*.<sup>25</sup>

It may therefore assist the QCA to consider allocation of the Newlands renewals in the context of the broader contractual arrangements, as described by Aurizon to their investors in June 2016.<sup>26</sup>

In addition, QCA's role in considering regulatory pricing so that *"the prices charged by regulated firms are sufficient to generate adequate revenue to provide appropriate incentives for investment and efficient operations."*<sup>27</sup> can be met by any allocation of the renewal costs between Newlands and GAPE Users.

The allocation in the Tariff Submission provides no incentive to Aurizon Network to achieve or even aim for economic efficiency in the allocation of the recovery of renewals capital.

---

<sup>22</sup> Queensland Competition Authority, Statement of Regulatory Pricing Principles, August 2013, Page iv

<sup>23</sup> Ibid,

<sup>24</sup> Ibid, page 5

<sup>25</sup> Aurizon Network 2017 Access Undertaking, Annual review of Reference Tariffs – FY22, Page 29

<sup>26</sup> "UT4 Final Decision, Investor Briefing, June 2016, <https://www.asx.com.au/asxpdf/20160601/pdf/437mm8vgcd8ph2.pdf>

<sup>27</sup> Queensland Competition Authority, Statement of Regulatory Pricing Principles, August 2013, page 10.



## 2. Fairness

The Pricing Principles state that “where this is no clean economic efficiency basis, the classic notions of vertical and horizontal equity will be considered”.<sup>28</sup> and “there are cases in which application of fairness principles is required to achieve economic efficiency.”<sup>29</sup>

As an indicator of fairness, the Pricing Principles state:

*“the ‘user pays’ or ‘impactor pays” principle is consistent with the proposition that it is fair for any given user of a service..... that causes costs to be incurred, to pay for the costs directly associated with their use or action”.*<sup>30</sup>

To this point the Pricing Principles quote Kaserman and Mayo (1995, p.505) illustrating this:

*“Suppose that one particular group is not required to pay the costs it imposes on the firm to supply the services. Because the firm is legally entitled to recover all the costs it legitimately incurs, this means that some other group of customers will be required to pay more than the costs they cause to be imposed on society to support the underpayment by the former group. Although there may be legitimate equity reasons for deviating from cost-based prices for particular individuals or products, it seems to be a reasonable first step towards promoting equity to benefit with prices that reflect the costs caused by the consumption decision of customers who pay those prices.”*<sup>31</sup>

This quote is particularly relevant to the Tariff Submission.

Also relevant to consideration of fairness is whether the pricing arrangements are consistent with the reasonable expectations prior to investment in the GAPE Project. Newlands Users did not expect that they would pay for all capital costs associated with renewal of all assets in the Newlands system used by both Newlands and GAPE Users. Based upon the documentation submitted by Aurizon in the GAPE DAU, GAPE Users similarly expected that they would be required to pay for the capital expenditure, including renewals expenditure, associated with the GAPE in the Newlands system.

As Anglo American Pty Ltd stated in its submissions to the QCA on the Pricing Principles:

*“regarding to the fairness concept, the “reference transaction” must be considered. That is “what principles all parties to a transaction would have agreed to before they made any sunk investments.”*

## 7. Incentives to maintain and increase utilisation of the Newlands system.

In the Tariff Submission, Aurizon has stated as one of the reasons that its allocation produces economically efficient outcomes is:

*“the resultant GAPE Reference Tariff provides stronger price incentives to maintain and increase the utilisation of the Newlands Coal System at expiry of the GAPE contractual arrangements”;*<sup>32</sup>

As a rail network owner (not a User (miner)) Aurizon is not in a position to state what incentivises Users to maintain or increase their utilisation of the Newlands System (or any other system), although pricing is one such factor in that incentive, where there are alternatives. Utilisation of a rail system, to a very large extent, will be determined by factors outside Aurizon (or the QCA's) control,

<sup>28</sup> Queensland Competition Authority, Statement of Regulatory Pricing Principles, August 2013, Page v and page 20

<sup>29</sup> Ibid, Page 21

<sup>30</sup> Ibid, page 29

<sup>31</sup> Ibid, page 29

<sup>32</sup> Aurizon Network 2017 Access Undertaking, Annual review of Reference Tariffs – FY22, Page 28



namely the location and economic viability of continuing to rail from their mines to a particular port and their relative competitiveness with other mines.

In addition, as stated by Aurizon, the GAPE Project was founded on commercial arrangements both inside and outside the regulated environment. As Aurizon determined the term of its commercial contracts outside the regulatory framework, it was aware of the risks of potential stranded assets and will have considered this when structuring those arrangements.

#### **8. Conclusion**

The QCoal Group considers the allocation of Newlands shared rail corridor renewals expenditure between Newlands and GAPE Train Services as set out in the Tariff Submission is inappropriate and should not be approved by the QCA on the basis that:

- Aurizon Network's rationale for their allocation is not consistent with the Pricing Principles.
- Is inconsistent with the foundation concept in Access Undertakings that users pay for costs they cause.
- The expectations of both Newlands and GAPE Users at the establishment of the GAPE Project and the GAPE reference tariff; and
- Aurizon has not shown that its allocation is economically efficient or fair.

Thank you for the opportunity to provide this submission.

Yours sincerely



Deborah Silver  
**Manager Infrastructure, QCoal Group**