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COUNCIL

*Resourcing Queensland's future*

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Queensland Competition Authority
145 Ann Street
Brisbane QLD 4000
(Submitted via QCA Online Submission Form)

**RE: Aurizon Network Draft Amending Access Undertaking – Electric Energy Charge FY23: Draft Decision**

The Queensland Resources Council (**QRC**), on behalf of the QRC's Rail Working Group, welcomes the opportunity to comment on the QCA's Draft Decision on Aurizon Network's Draft Amending Access Undertaking – Electric Energy Charge FY23 (the DAAU).

## 1. Introduction

The QCA's Draft Decision indicates that the QCA is minded to approve the DAAU, in part because "*there is insufficient evidence to demonstrate that Aurizon Network acted imprudently*" (Draft Decision, Page 5). The QRC's concerns regarding the prudency of Aurizon Network's management were not based upon the additional $121.7 million cost compared to FY22 tariffs. We are well aware of the changes in the electricity market and the impacts which this has had on many consumers of electricity. Our concerns were based upon observations that Aurizon Network:

- Put itself in the position of being totally uncontracted and unhedged shortly before the commencement of FY23.
- Failed to inform customers of the exposure or to consider mitigation options, including hedging.
- Failed to demonstrate to customers that it followed expert advice, and instead claimed that the advice is confidential (despite the now outdated nature of the advice).
- Failed to fill the role of '*electricity industry specialist*', despite successfully arguing for funding for this role during the UT5 process.

The information provided by Aurizon Network to date, and the QCA's analysis provided in the Draft Decision, has not provided us with any basis which to conclude that Aurizon Network's management was prudent and was not a key contributor to the exposure which customers have suffered.

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## 2. Comments on elements of the Draft Decision

This section provides comments on specific elements of the Draft Decision:

Advice of Edge2020:

In QRC's July 2022 submission, we encouraged the QCA to assess the extent to which Aurizon Network relied upon expert advice from Edge2020. Our understanding is that Edge2020's advice covers two elements of electricity procurement:

- When a new retail contract is required, advice on the process for sourcing and negotiating such a contract.
- Under a progressive purchasing model, providing recommendations on when to 'lock in' the price of 'blocks' of future demand.

The Draft Decision discusses the first of these roles only. The second function is arguably the more important in terms of managing exposures to the electricity market and determining cost outcomes. We are no clearer on the question of whether Edge2020, during 2021 and early 2022, provided warnings to Aurizon Network of the risk of significant price rises (particularly from the historic low levels seen during these years including in futures markets), and if so, whether Aurizon Network acted prudently in failing to act in response to such warnings.

Progressive Purchasing:

The QCA notes that "*in both our draft and final decisions on Aurizon Network's 2017 DAU, we noted that moving to progressive purchasing will expose Aurizon Network's customers to significant short-term price risk, which must be managed effectively - but were mindful that Aurizon Network had consulted with its users who endorsed the proposed approach at that time*" (Draft Decision, Page 6). It is true that Aurizon Network's customers endorsed, and continue to endorse, a progressive purchasing approach. As the QCA noted, this involves significant short-term price risk which must be managed effectively. In the absence of effective management, a progressive purchasing approach increases risks and could not be supported by customers. The issue here is not progressive purchasing as a procurement model, it is the prudency of the management of this activity.

Incentives:

The Draft Decision notes that Aurizon Network has several incentives to procure electricity in an efficient manner. However, those incentives are weak:

- The impact of electricity costs on the related operator are limited, as electricity costs are generally (if not always) a pass-through cost to customers under haulage agreements where Aurizon Operations holds the access. Where customers hold access directly (which is increasingly common), Aurizon Operations has little to no risk in the short term.
- The electricity demand of the Aurizon Group's broader Queensland business is small compared to that of the CQCN, therefore the effect on those operations is limited.
- Aurizon Network's incentive to maintain the competitiveness of electric traction in the CQCN has been significantly reduced by the Electric Traction DAAU (approved by the QCA in 2019), as this DAAU requires that, in the event of a significant decline

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in the percentage of services using electric traction, diesel services will be exposed to charges relating to electric infrastructure.

Hedging

QRC considers that Aurizon Network ought to have made customers aware of its exposed position leading into FY23. This position arose from not having a retail contract until very close to the commencement of the year, then having a retail contract in which the price of only a small portion of the expected demand was locked in. In these circumstances, Aurizon Network should have presented options to customers, including hedging outside the retail contract (e.g. through futures contracts). We understand that hedging in this way could have exposed customers to hedging losses, and we do not suggest that Aurizon Network should have unilaterally hedged its position, without prior consultation with customers. What we find extremely disappointing is the fact that Aurizon Network appears to have dismissed this option on the basis that it would require consultation with customers, as though a requirement to consult is a fatal flaw. We are also disappointed that the Draft Decision discusses and dismisses an extreme version of this option which was not suggested by customers (that is, Aurizon Network unilaterally hedging, without consultation) and fails to address the more reasonable suggestion, that Aurizon Network, if managing this function prudently, ought to have considered hedging and discussed it with customers.

Operating Cost Allowance

As was noted in our July submission, Aurizon Network sought, under UT5, funding for an "*electrical specialist role*" to "*engage in regulatory and policy processes regarding electricity wholesale and network issues*". The QCA's Draft Decision on UT5 did not accept this allowance. In response, Aurizon Network provided further information on this importance of the role, which included "*more efficiently managing energy procurement, through progressive purchasing and pricing*". It seems clear from Aurizon Network's UT5 submission that managing this activity without an electrical specialist is, in Aurizon Network's view, imprudent. Therefore, Aurizon Network's decision to take this funding, but not fill the role, is an indicator of imprudent management, which may have contributed to the current situation.

In response to these concerns, the Draft Decision (page 9) states that "*in setting an operating cost allowance, we set an overall allowance in order to provide the business with the incentive to manage its affairs within this amount. We do not prescribe how Aurizon Network manages its own business*". We find this response extremely disappointing, because:

- We are unable to identify the 'incentives' to which the QCA is referring, given the QCA's acceptance (Draft Decision, Page 5) that EC is "*a straight cost pass-through*".
- While we understand that the regulatory arrangements allow Aurizon Network to seek and obtain operating cost allowances, then keep the savings if costs can be lowered or avoided, Aurizon Network's decisions to do so should not be without consequence. In cases where Aurizon Network's decisions to cut operating costs result in inefficient outcomes, then Aurizon Network's recovery of resulting costs should be limited to efficient costs.

No Direct Commodity Exposure

The Draft Decision notes (Page 6) "*Aurizon Network has indicated that, with regard to its electricity supply procurement, all risk management activities are undertaken by the retailer under the terms of the supply agreement. It said that it has no direct exposure to the wholesale cost of electricity*".

We simply do not understand what point is being made by Aurizon Network when it says that it has no direct exposure to the wholesale cost of electricity, nor why the QCA has included this statement within the Draft Decision. Aurizon Network may have no "direct" exposure, but the indirect exposure is made clear by the proposed $121.7m cost increase, and by the fact that the purpose of the DAAU is to address "*the increase in wholesale pricing*" (Aurizon Network supporting submission, June 2022). Whether the exposure is direct or indirect is of little consequence.

Also, the claim that "*all risk management activities are undertaken by the retailer*" is concerning. From the perspective of customers, the key risk management activity under a progressive purchasing contract is the decision to lock in the pricing of particularly 'blocks' of forecast demand at various times ahead of the relevant period. Aurizon Network is in control of those key decisions.

<u>Reforms: Customer Input</u>

We welcome the QCA's comments regarding the need to improve customer consultation and input. There is now significant consultation and meaningful engagement regarding the maintenance and renewals program, and it is unacceptable that a cost which now has a value similar to the maintenance program is incurred and passed through without meaningful consultation. Aurizon Network has continued to make major decisions in electricity procurement in recent months, without consultation, despite the well-known concerns of customers.

Customers are considering the extent of input which is required, in light of recent events. Customers are fully exposed to this cost, while Aurizon Network processes this cost as a pass-through and faces no risk and minimal incentive. Options to be considered will include:

- Improved consultation and input, which will require Aurizon Network to make genuine efforts to address confidentiality constraints.
- Requiring that key decisions (included the decision to lock in blocks of demand under the retail contract) proceed only with customer approval.
- Aurizon Network facilitating the option for individual customers to procure their own electricity.
- A full transfer of the management of this function to an independent party.

We note that, as provided for in clause 2.6(a) of the undertaking and acknowledged in the QCA's draft decision, Aurizon Network is not required to sell electricity to rail operators. Aurizon Network is however required to 'offer' to supply electricity where Aurizon Network supplies electricity to its related rail operator. Rail operators are not obliged to purchase electricity from Aurizon Network, and it is open to them and their customers to manage their own electricity procurement requirements. Given this position under UT5, we expect Aurizon Network to cooperate with any customer or group of customers which elects to manage its own electricity procurement.

We will seek to reach agreement on appropriate processes with Aurizon Network, failing which customers may elect to submit an End User DAAU under UT5.

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Thank you for the opportunity to provide this submission.

Yours sincerely

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