

Supplementary Draft Decision

Aurizon Network 2014 DAU: Reference Tariffs for Wiggins Island Rail Project Train Services

July 2015

We wish to acknowledge the contribution of the following staff to this report:

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SUBMISSIONS

Closing date for submissions: 11 September 2015

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 Reference Tariffs for Wiggins Island Rail Project Train Services. The QCA will take account of all submissions received.

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

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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.

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EXECUTIVE SUMMARY

Our draft decision is to refuse to approve Aurizon Network's proposed approach to pricing of the Wiggins Island Rail Project (WIRP) train services. Instead, our draft decision takes an approach that:

- (a) for WIRP customers in the Moura rail system, results in a premium above the existing system tariffs*
- (b) for WIRP customers in the Blackwater rail system
 - (i) retains the tariff premium paid by the Rolleston mine*
 - (ii) socialises a portion of WIRP Blackwater costs across existing users using WIRP*
 - (iii) defers the recovery of the remaining WIRP Blackwater costs until volumes increase.**

Aurizon Network's access undertaking

Aurizon Network owns and operates the rail network in central Queensland. The network is mainly used to carry coal to export ports near Gladstone, Mackay and Bowen.

Under the *Queensland Competition Authority Act* (the QCA Act), Aurizon Network can provide an undertaking setting out its proposed terms and conditions for access to the network. Since 2001, we have approved three such undertakings. The latest undertaking, known as the 2010 AU, is scheduled to expire on 29 February 2016. In August 2014, Aurizon Network submitted a draft access undertaking (the 2014 DAU) to take effect from the expiry of the 2010 AU.

Wiggins Island Rail Project

WIRP is a series of individual rail expansion and upgrade projects in the Moura and Blackwater coal systems. The expansion is in conjunction with the Wiggins Island Coal Export Terminal (WICET) which will deliver export capacity of 27 million tonnes of coal in the first stage. In total, WIRP is forecast to cost \$945 million.

As part of its 2014 DAU proposal, Aurizon Network submitted its proposed pricing arrangements for WIRP. Subsequent to this, it put forward an alternative approach to WIRP pricing under a separate process (December 2014).

This supplementary draft decision relates to WIRP only. However, we emphasise our task is to assess the 2014 DAU as a whole. In doing so, we may approve 2014 DAU (and hence those reference tariffs) only if we consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act. We note that we are not considering what access undertaking (and hence reference tariffs) would be appropriate, or most appropriate; we are rather considering whether it is appropriate to approve the 2014 DAU (and hence reference tariffs for WIRP) as submitted and if not, why not.

Our final decision will encompass all aspects of the 2014 DAU, including the treatment of WIRP.

Our WIRP draft decision

Our draft decision seeks to balance the interests of Aurizon Network, access seekers, access holders and other stakeholders, as well as the public. Importantly, it ensures risks are borne by parties best able to manage them. For example, we have sought to minimise the risk that existing, non-WIRP users will bear the costs of WIRP.

For Blackwater and WIRP Blackwater customers, our draft decision:

- socialises a portion of WIRP Blackwater costs within the existing Blackwater system, while deferring the recovery of some WIRP Blackwater costs to reflect the forecast that some WIRP users will not rail during this regulatory period
- requires the Rolleston customer to pay a premium on the existing Blackwater tariff reflecting its higher costs, including costs associated with WIRP.

For Moura and WIRP Moura customers, our draft decision:

- requires WIRP Moura customers to pay a premium on the existing tariff to reflect the higher costs associated with WIRP.

For the WIRP North Coast Line (NCL) train service from Colton, we have accepted an alternative approach to pricing to ensure it pays a reasonable contribution to common costs over the remainder of the regulatory period.

Our analysis

As part of our application of the factors set out in section 138(2) of the QCA Act to the proposed WIRP reference tariffs, we have considered a range of matters associated with the treatment of WIRP pricing under the 2014 DAU. Our detailed analysis and reasoning are contained in this draft decision.

Chapter 3 reviews the historical context to the proposed pricing arrangements for WIRP and concludes that:

- although customer endorsement of the 2008 Coal Rail Infrastructure Master Plan (CRIMP) occurred, the endorsement was negated by subsequent changes in scope and circumstances and is therefore not determinative of the allocation of WIRP capital costs under the 2014 DAU
- it would not be appropriate to exclude consideration of the WIRP access conditions when forming our draft decision
- while the 2010 AU provisions relating to WIRP pricing are relevant to our consideration of the WIRP pricing arrangements, we do not consider these provisions are determinative. Aspects of Aurizon Network's proposed 2014 DAU, as well as our proposed amendments (as set out in our January 2015 Draft Decision), are also relevant considerations in our assessment of WIRP pricing under the 2014 DAU.

Chapter 4 assesses the appropriateness of Aurizon Network's proposal for allocating costs and volumes between WIRP and existing customers under the 2014 DAU and develops our proposed WIRP costs and volumes for analysis of WIRP pricing options. It presents our draft decision to:

- refuse to approve Aurizon Network's proposed allocation of a proportion of Blackwater capital costs to existing users for pricing purposes. We consider it appropriate to not allocate any capital costs to existing Blackwater users
- refuse to approve Aurizon Network's proposed allocation of operating and maintenance costs to WIRP train services in its 2014 DAU proposal. We consider it would be appropriate to use Aurizon Network's December 2014 proposed WIRP operating and maintenance costs for 2015–16 and 2016–17
- adopt the forecast volumes for WIRP and non-WIRP train services consistent with Energy Economics' forecasts and our adjustments to cap WIRP volumes to contracted volumes.

Chapter 5 assesses options for WIRP pricing in order to enable us to determine the appropriateness of the tariffs proposed under the 2014 DAU. We identified three options for WIRP pricing:

- socialised pricing approach—all WIRP and non-WIRP train services pay the same system reference tariff (with combined take-or-pay arrangements and revenue cap)
- system premium approach—a system reference tariff is set, but in addition WIRP users pay a premium to reflect their higher incremental costs (combined take-or-pay arrangements and revenue cap still apply as per the socialised pricing approach described above)
- separate reference tariff— WIRP costs and volumes are allocated to a new coal system or a separate expansion tariff is set for pricing purposes (with separate take-or-pay arrangements and revenue cap).

We conclude the pure socialised pricing approach is not appropriate as the socialised price is higher than the average existing price (in both Blackwater and Moura systems). If a separate reference tariff is applied in the Blackwater system, the substitutability of volumes could have the effect of shifting volume risk to existing customers. We therefore prefer the system premium approach.

Chapter 6 applies the system premium approach to determine the most appropriate pricing arrangements for WIRP over the 2014 DAU regulatory period:

- Blackwater—we have set out the key steps we have taken in determining an appropriate reference tariff for WIRP and non-WIRP train services in the Blackwater system, including a system premium for the Rolleston customer. In addition, to address the impact of WIRP customers that are not expected to rail during the 2014 DAU period, we propose a revenue deferral mechanism to address the impact on expanding users resulting from the expected underutilisation of WIRP capacity over the remainder of the 2014 DAU period.
- Moura—we consider the application of a system premium for WIRP train services in Moura to be appropriate to ensure WIRP users pay efficient costs and minimise the impact on existing Moura customers.
- NCL—we consider that it is appropriate to approve Aurizon Network's approach to pricing arrangements for the WIRP NCL train service, escalated according to the CPI over the 2014 DAU regulatory period.

Our approach will result in all customer groups paying a reference tariff that reflects the costs attributable to their train services. The additional revenue to meet the costs of WIRP will be recovered over 2015–16 and 2016–17 through additional volumes being railed by WIRP users.

Way forward

This draft decision explains our views on WIRP pricing arrangements under the 2014 DAU. These views may change in response to issues raised by stakeholders in response to this draft decision.

We will finalise the 2014 DAU process as soon as practicable. However, the timeframe will, in part, depend on the timeliness and complexity of stakeholders' responses to this draft decision.

Submissions

We invite written submissions on this draft decision. Submissions must be received by no later than **11 September 2015**. We will consider all submissions received by this date.

THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS

The Queensland Competition Authority (QCA) is an independent statutory authority established to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

Our primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

In 2012, that role was expanded to allow us to be directed to investigate, and report on, any matter relating to competition, industry and review and report on existing legislation.

Task, timing and contacts

On 11 August 2014, Aurizon Network submitted a Draft Access Undertaking (the 2014 DAU) for our approval. This followed extensive consultation between Aurizon Network and stakeholders on Aurizon Network's original UT4 proposal (the now-withdrawn 2013 DAU).

We are undertaking an investigation into the 2014 DAU in accordance with section 146 of the QCA Act. We are required to either approve, or refuse to approve, the 2014 DAU. We are assessing the 2014 DAU in the context of the statutory access regime in the QCA Act and, in particular, the criteria for approval of undertakings in section 138(2) of the QCA Act, including the object of Part 5 (section 69E).

In August 2014, Aurizon Network provided us with a supporting submission in respect of its Wiggins Island Rail Project (WIRP) pricing proposal for the 2014 DAU. We published this submission for stakeholder comments.

On 26 November 2014, in response to stakeholder submissions, we asked Aurizon Network for a more comprehensive tariff proposal for WIRP that could be used for a further round of stakeholder consultation in the context of our assessment of the 2014 DAU.

On 18 December 2014, Aurizon Network provided us with a WIRP pricing proposal pursuant to clause 6.4.2 of the 2010 Access Undertaking (2010 AU), which included 'transitional' reference tariffs for 2014–15 to 2016–17.¹ We also sought stakeholder submissions on this proposal, and requested additional information from stakeholders where additional evidence was required to support their claims.

On 22 April 2015, we approved Aurizon Network's proposal for transitional tariffs for WIRP for 2014–15 under the 2010 AU. We could not approve tariffs for 2015–16 and 2016–17 at that time, as the 2010 AU was due to expire at the end of June 2015.

We then received a separate proposal from Aurizon Network, which we approved on 5 June 2015—extending the 2010 AU until 29 February 2016. We also approved transitional reference tariffs to apply to all coal-carrying train services in 2015–16, including WIRP train services.

Key dates

We are required to undertake our investigation of the 2014 DAU in accordance with Part 6 of the QCA Act, which allows for a high degree of flexibility in the manner in which we conduct an investigation. For the purposes of the 2014 DAU investigation we have published three draft decisions to date:

¹ When it submitted its December 2014 WIRP pricing proposal, Aurizon Network did not withdraw its August 2014 submission, provided as part of the 2014 DAU. We have considered both proposals as part of this draft decision (discussed further in section 1.3).

- the Maximum Allowable Revenue (MAR) aspects of the 2014 DAU, published on 30 September 2014
- the policy and pricing aspects of the 2014 DAU (excluding the treatment of WIRP), on 30 January 2015
- the capacity transfer mechanism 2014 DAU supplementary Draft Decision on 30 April 2015.

This supplementary draft decision considers Aurizon Network's 2014 DAU submission relating to the revenue and pricing treatment of WIRP under the 2014 DAU. However, as part of this decision, we have also considered the relevant aspects of Aurizon Network's December 2014 WIRP pricing proposal which related to the 2010 AU. Our 2014 DAU final decision will encompass all aspects of the 2014 DAU.

We have determined a proposed timetable for developing our 2014 DAU final decision, as outlined in Table 1 below. Meeting this timetable will be dependent on the scope and complexity of issues raised by stakeholders in response to our draft decisions as part of the consultation and submission phases.

Table 1 Timetable

<i>Task</i>	<i>Indicative date</i>
2014 DAU submission	11 August 2014
2014 MAR Draft Decision	30 September 2014
2013 SUFA DAAU Draft Decision	31 October 2014
2014 DAU Draft Decision (on remaining matters)	30 January 2015
Submissions on 2014 DAU Draft Decision (on remaining matters) due	17 April 2015
Capacity Transfer Mechanism Supplementary Draft Decision	30 April 2015
Submissions on Capacity Transfer Mechanism due	29 May 2015
WIRP Supplementary Draft Decision	July 2015
2013 SUFA DAAU Final Decision	August 2015
Submissions on WIRP Supplementary Draft Decision due	11 September 2015
2014 DAU Final Decision	30 October 2015

Submissions

We seek submissions regarding our draft decision on WIRP pricing presented in this paper. Submissions must be received by no later than **11 September 2015**. We will consider all submissions received within this timeframe.

Contacts

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1 INTRODUCTION

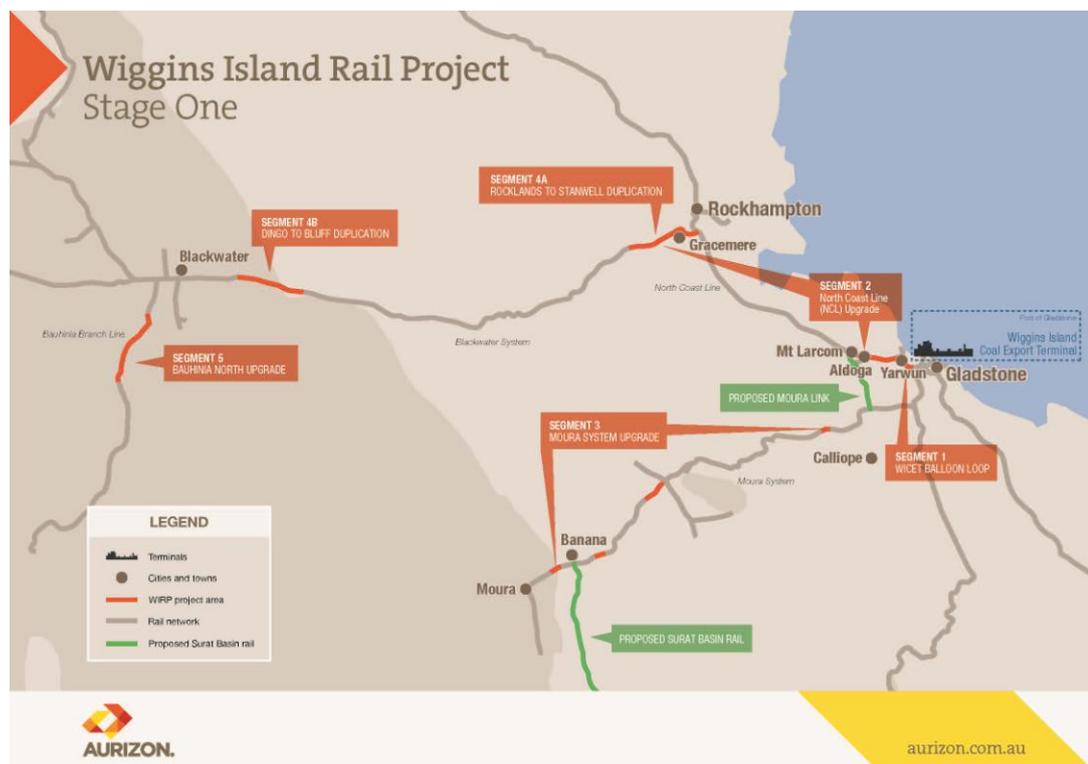
1.1 Wiggins Island Rail Project

The Wiggins Island Coal Export Terminal (WICET) is an industry funded terminal that will be integrated with the existing infrastructure at the Port of Gladstone. Being built in stages, WICET aims to deliver 27 million tonnes per year of export capacity to a consortium of eight coal exporters with the completion of its first stage.²

Significant rail infrastructure is required in conjunction with WICET in the Moura and Blackwater coal systems. Wiggins Island Rail Project (WIRP) refers to a series of individual geographically distinct rail infrastructure projects in the southern Bowen Basin. These projects are collectively known as the WIRP Stage 1 expansion and consist of six project segments, including a new balloon loop, track duplications and upgrades (Figure 1).³

References to 'WIRP' throughout this paper refer collectively to all WIRP Stage 1 expansion projects.

Figure 1 Map of WIRP rail infrastructure segments



Source: Aurizon Network website at http://www.aurizon.com.au/Downloads/WIRP%20Stage1MAP_JUL2013.pdf

New and existing users of the central Queensland coal network (CQCN) have contracted below-rail capacity for access to WICET. These parties, referred to as WIRP customers by Aurizon Network, consist of:

² The eight users involved in WICET Stage 1 are Aquila Resources, Bandanna Energy, Caledon Resources, Cockatoo Coal, Glencore Xstrata, Northern Energy Corporation, Wesfarmers Curragh and Yancoal.

³ A more detailed scope is provided in Section 1.2.

- WIRP Blackwater—customers who have contracted train services under WIRP arrangements and are geographically located in the Blackwater system
- WIRP Moura—a customer who has contracted train services under WIRP arrangements and is geographically located in the Moura system
- WIRP NCL—a customer who has contracted train services originating from the Colton mine to WICET (referred to as the North Coast Line (NCL) train service) under WIRP arrangements.

Train services to WICET, referred to as WIRP train services, commenced in March 2015.

1.2 WIRP—scope and costs

WIRP comprises the construction of new infrastructure and upgrades to existing coal rail infrastructure in the Blackwater and Moura systems, with a total forecast capital cost of \$945.3 million,⁴ comprising project segments outlined in the table below.

Table 2 WIRP scope and costs (nominal)

<i>Project segment (capital costs)</i>	<i>Description</i>
Wiggins Island balloon loop (\$245.8 million)	<ul style="list-style-type: none"> • Construction of a single electrified rail spur and balloon loop near Yarwun • Replacement of major components of the Callemondah Feeder Station
Blackwater duplications (\$424.8 million)	<ul style="list-style-type: none"> • Duplication of 18 km of track between Rocklands and Stanwell • Duplication of 24 km of track between Dingo and Bluff • Upgrades to existing infrastructure • Rationalisation and optimisation of rail/road crossings
Bauhinia North upgrades (\$17.3 million)	<ul style="list-style-type: none"> • Construction of a new passing loop, and upgrades to existing rail Infrastructure
Moura system upgrades (\$48.3 million)	<ul style="list-style-type: none"> • Replacement and upgrades to existing rail formation and track • Upgrades to rail/road crossings
NCL upgrades (\$209.1 million)	<ul style="list-style-type: none"> • Triplication of the NCL at Yarwun • Construction of two new holding roads at Kabra and one at Aldoga • Upgrades to the Yarwun ballast siding • Upgrades to rail/road crossings

Source: Aurizon Network, 2014(g): 7, 17. Note, capital costs are mid-year values, including interest during construction (IDC)

Aurizon Network said project segments included in WIRP are fully integrated with the existing mainline infrastructure of the Blackwater and Moura systems, except for the Wiggins Island balloon loop and part of the Moura West upgrades.⁵ According to Aurizon Network, 70 per cent of the total WIRP capital value relates to infrastructure that will be used by both WIRP and non-WIRP customers in the Blackwater and Moura systems. Approximately 94 per cent of the capital value of WIRP relates to multi-user infrastructure.

⁴ Aurizon Network said the WIRP forecast capital costs were consistent with the Capital Indicator that was submitted as part of Aurizon Network's response to the QCA's Draft Decision on the MAR.

⁵ Aurizon Network, 2014(g): 8; Aurizon Network, 2014 DAU, sub. no. 6: 3

In addition, Aurizon Network said both WIRP and non-WIRP customers in the Blackwater and Moura systems will gain operational benefits from WIRP. The operational benefits, as set out in more detail in Aurizon Network's December 2014 pricing proposal, include:

- the Blackwater duplications will provide greater planning flexibility, fewer contested paths, and a greater ability to recover from day of operations losses and maintenance activities
- the renewal of signalling equipment in the Blackwater system and on the NCL will improve signalling reliability in the CQCN. Previously, the older signalling equipment contributed to train delays and loss of capacity
- the NCL upgrades include replacing track circuits with axle counters. These upgrades are expected to improve the robustness and reliability of infrastructure in the Gladstone area. The resulting reductions in congestion will benefit Blackwater and Moura customers.⁶

Aurizon Network also said the Moura East project includes rail replacement, renewals and strengthening in the Moura system. These works are expected to contribute to reductions in maintenance activities and costs in the Moura system.

Access conditions for WIRP

The 2010 AU provides that Aurizon Network may require access seekers to agree to additional conditions (access conditions) to the extent the conditions are reasonably required to mitigate exposure to the financial risks of providing access. The 2010 AU also provides a mechanism for us to approve the access conditions, with different approval criteria depending on whether the parties have agreed to the access conditions or not.

In September 2011, Aurizon Network and WIRP customers agreed access conditions to apply to WIRP. The access conditions are contained in deeds between Aurizon Network and each of the WIRP users and are encapsulated in a fee (WIRP fee). Appendix B contains a summary of the risks Aurizon Network stated were covered by the WIRP fee.

In May 2012, we approved the WIRP access conditions. We found they would not impact adversely on the public interest or disadvantage stakeholders. Given the access conditions were submitted with the support of WIRP users, our assessment did not look at the reasonableness of the WIRP access conditions, including whether they were required to mitigate Aurizon Network's financial risks and whether these risks were covered by existing arrangements.

1.3 Reference tariffs for WIRP train services

Aurizon Network has submitted two separate pricing proposals for WIRP train services: one as part of its 2014 DAU submission; the other its December 2014 pricing proposal submitted pursuant to clause 6.4.2 of the 2010 AU. We note that our focus under the QCA Act must be on whether we consider it appropriate to approve the 2014 DAU, hence our focus is necessarily on the reference tariffs for WIRP submitted in relation to the 2014 DAU. Notwithstanding, we have also considered the December 2014 pricing proposal in our analysis.

1.3.1 2014 DAU submission

As part of its 2014 DAU submission, Aurizon Network proposed pricing arrangements for WIRP train services. In August 2014, Aurizon Network provided a separate guidance note which outlined the revenue and pricing treatment of WIRP train services under its proposed 2014

⁶ Aurizon Network, 2014(g): 10

DAU. This proposal was similar to what had been set out under Aurizon Network's withdrawn 2013 DAU. Aurizon Network said that its proposed pricing approach was guided by pricing principles in the 2014 DAU and the legislative requirements of the QCA under section 138 of the QCA Act.⁷

In its 2014 DAU submission, Aurizon Network proposed the incremental costs associated with WIRP be socialised across all users within the Moura and Blackwater systems. This would result in all users (WIRP or non-WIRP) of the Moura and Blackwater systems sharing the costs and risks of the WIRP infrastructure.⁸ Subsequent stakeholder submissions reflected strongly opposing views as to whether the incremental costs of WIRP should be shared across all system users or borne only by WIRP customers.

On 26 November 2014, in response to stakeholder submissions, we asked Aurizon Network for a more comprehensive tariff proposal for WIRP that could be used for further stakeholder consultation in the context of our consideration of the 2014 DAU. In particular, we requested that Aurizon Network's WIRP proposal consider, amongst other things:

- more up-to-date estimates of WIRP project costs and ramp-up tonnages for the WIRP infrastructure
- information on whether WIRP has been the subject of any form of previous customer voting
- Aurizon Network's perspective on the socialisation of WIRP, including what agreements or understandings it might have had with existing and new customers about the consideration of an expansion tariff for the project
- the rationale for the proposed allocation of one-seventh of the capital costs of Blackwater duplications to existing customers, in the event that an expansion tariff is considered rather than socialisation.

Given the significance of the issues associated with Aurizon Network's submission in August 2014, we decided to address our decision regarding the reference tariffs for WIRP via a supplementary Draft Decision as part of the 2014 DAU process, but to be released subsequent to the overarching 2014 DAU Draft Decision (Policy and Pricing) published in January 2015. As a result, the reference tariff calculations in our January 2015 Draft Decision regarding the 2014 DAU excluded costs and volumes associated with WIRP.

1.3.2 December 2014 pricing proposal

On 18 December 2014, Aurizon Network submitted a pricing proposal for WIRP train services pursuant to clause 6.4.2 of the 2010 AU, rather than as a submission on the 2014 DAU. The proposal comprised 'transitional' reference tariffs under the 2010 AU for 2014–15 through to 2016–17.⁹ We sought stakeholder submissions on this proposal, and requested additional information from stakeholders to support some of their claims in relation to WIRP.

On 20 February 2015, we sought further advice from Aurizon Network on the legal basis for this proposal, given that it was unclear how reference tariffs for periods beyond the term of the 2010 AU could be consistent with the 2010 AU as required by clause 6.4.2(g)(i) of the 2010 AU.

⁷ Aurizon Network, 2014 DAU, sub. no. 6: 2–3

⁸ Aurizon Network also proposed an alternative reference tariff for the NCL train service, based on the Colton to Barney Point Alternative Access Charge proposal that we approved in March 2012 (Aurizon Network December 2013 Financial Model; QCA, 2012(e))

⁹ At the time, proposing tariffs for 2015-16 and 2016-17 was beyond the term of the 2010 AU (the 2010 AU has since been extended via a separate proposal and will expire 29 February 2016).

On 6 March 2015, Aurizon Network acknowledged we do not have the power to approve reference tariffs beyond the 2010 AU period under clause 6.4.2 of the 2010 AU. Aurizon Network clarified that the purpose of the pricing proposal was also to seek our approval of:

- Aurizon Network's proposed methodology to be applied to calculate WIRP tariffs, as well as our confirmation that WIRP tariffs in the 2014 DAU would be determined on the basis of the methodology outlined in the pricing proposal
- 'transitional' WIRP tariffs for the rest of the 2010 AU period.

Under the pricing proposal for 2014–15, the existing transitional reference tariff for the Blackwater and Moura systems would be applied to WIRP train services originating from the respective systems. Any access revenues received from these train services in 2014–15 would be credited against WIRP allowable revenues for the succeeding year.

For 2015–16 and 2016–17, Aurizon Network proposed:

- a socialised Blackwater system reference tariff for both WIRP and non-WIRP train services in the Blackwater system
- a system premium on top of the Moura system reference tariff for WIRP train services in the Moura system
- an alternative reference tariff for the NCL train service based on the pricing approach that we approved in March 2012 for the Colton to Barney Point train service.

On 22 April 2015, we approved Aurizon Network's proposed WIRP transitional reference tariff for 2014–15 under the 2010 AU. At the time, the 2010 AU had not been extended beyond the 30 June 2015, so we could not approve tariffs beyond this.

On 5 June 2015, we approved Aurizon Network's proposal to extend the 2010 AU until 29 February 2016. We also approved transitional reference tariffs for coal-carrying train services, including WIRP for 2015–16.

1.4 Key issues for consideration

Aurizon Network's WIRP pricing proposals have raised a number of further issues for our consideration as part of this assessment, including:

- **the level and extent of historic customer engagement undertaken by Aurizon Network, including the representations made to**
 - WIRP and non-WIRP customers about the need for infrastructure upgrades to the Blackwater and Moura systems
 - WIRP and non-WIRP customers about how the pricing arrangements are to apply to WIRP
- **historic expectations regarding the applicable regulatory framework, including**
 - how pricing matters crossing two regulatory periods are considered, i.e. whether we should be considering pricing principles for the WIRP projects based on the 2010 AU or 2014 DAU provisions
- **appropriate allocation of risks between different stakeholders, including whether**
 - we should have regard to the WIRP fee (payable by WIRP customers to Aurizon Network under the approved form of access conditions) in considering the pricing arrangements

- there is a case for the WIRP costs to be socialised across all users rather than just WIRP customers, as proposed by Aurizon Network (and WIRP customers)
- **the possibility of shifting existing volumes to WIRP infrastructure and**
 - how this should be treated when identifying volumes attributable to WIRP
 - the implications this has for reference tariffs and take-or-pay arrangements.

These issues are discussed in detail in the following chapters of this draft decision.

2 LEGISLATIVE FRAMEWORK AND ASSESSMENT APPROACH

We are assessing the 2014 DAU, including the WIRP pricing arrangements, in the context of the statutory access regime in Part 5 of the QCA Act.

Under section 138(2) of the QCA Act, we may approve the 2014 DAU (including reference tariffs for WIRP) only if we consider it appropriate to do so having regard to each of the factors in section 138(2) of the QCA Act. These factors include, for example, the object of Part 5 and the pricing principles in section 168A as well as any issues we consider relevant.

When having regard to the factors contained in section 138(2) of the QCA Act, we must apply a weighting to each factor we consider is appropriate based on the practical relevance of the factor to our decision. We also have to balance the factors, as we see appropriate, consistent with this weighting. This has required us, for example, to balance the legitimate business interests of Aurizon Network with the interests of customers who have invested in WIRP infrastructure as well as those who have not (non-WIRP customers).

2.1 Part 5 of the Queensland Competition Authority Act 1997

Part 5 of the QCA Act sets out the legislative framework for Queensland's third party access regime. Part 5 provides the legislative framework for facilitating access to services provided by means of infrastructure through:

- the declaration by the QCA of a service and arbitration of access disputes
- the provision and administration of access undertakings by the QCA
- the ability of the QCA to make access codes for declared services and provide rulings.

The use of a coal system for providing transportation by rail is a declared service for the purposes of Part 5 of the QCA Act by operation of section 250 of the QCA Act and is referred to in this draft decision as the 'declared service'.¹⁰ The declared rail transport infrastructure is collectively referred to in this draft decision as the 'central Queensland coal network' (CQCN).

As a result of the declaration of the use of the CQCN, Aurizon Network (as access provider) and access seekers are subject to various rights and obligations under the access regime in Part 5 of the QCA Act.

2.2 Section 138(2) of the QCA Act

We may only approve the 2014 DAU (including the reference tariffs for WIRP) if we consider it appropriate to do so having regard to each of the factors specified in section 138(2) of the QCA Act (see Box 1).

¹⁰ A 'coal system' means rail transport infrastructure (a 'facility' under section 70 of the QCA Act) that is part of the Blackwater system, Goonyella system, Moura system or Newlands system, and which includes direct or indirectly connected rail transport infrastructure owned or operated by Aurizon Network, or which includes particular extensions built on or after 30 July 2010 owned or operated by Aurizon Network, as defined in section 250 of the QCA Act.

Box 1: The legal framework

The Authority may approve a draft access undertaking only if it considers it appropriate to do so having regard to each of the following —

- (a) the object of this part;
- (b) the legitimate business interests of the owner or operator of the service;
- (c) if the owner and operator of the service are different entities—the legitimate business interests of the operator of the service are protected;
- (d) the public interest, including the public interest in having competition in markets (whether or not in Australia);
- (e) the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected;
- (f) the effect of excluding existing assets for pricing purposes;
- (g) the pricing principles mentioned in section 168A;
- (h) any other issues the authority considers relevant.

The 'object of this part' referred to in section 138(2)(a) is set out in section 69E:

The object of this part is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets.

The section 168A pricing principles are:

The pricing principles in relation to the price of access to a service are that the price should —

- (a) generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved; and
- (b) allow for multi-part pricing and price discrimination when it aids efficiency; and
- (c) not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent the cost of providing access to other operators is higher; and
- (d) provide incentives to reduce costs or otherwise improve productivity.

In addition to having regard to the matters specified in section 138(2) of the QCA Act we may not refuse to approve an undertaking only because we consider a 'minor and inconsequential' amendment should be made to a particular part of the draft access undertaking (s. 138(5) of the QCA Act). The meaning of 'minor and consequential', in relation to part of a draft access undertaking, is an amendment that, if made, would have no real effect or consequence in relation to that part of the undertaking and the undertaking as a whole (s. 138(6) of the QCA Act).

Further, when determining whether we consider a draft access undertaking is appropriate we must have published the draft access undertaking, invited submissions on it and considered submissions received in the permitted time (s. 138(3) of the QCA Act). Outside these requirements and the requirements of natural justice we have wide discretion in how we determine whether or not it is appropriate to approve a draft access undertaking and (if not) what amendments we consider are required in order for us to consider it appropriate to approve the draft access undertaking. However, we must exercise that discretion bona fide and having regard to the policy and purpose of the QCA Act.

2.3 Approach for WIRP pricing

When considering whether or not to approve the reference tariffs for WIRP as part of the 2014 DAU, we apply the same approach. We are required 'to have regard to' each of the factors in

section 138(2), including the object of Part 5 and the pricing principles in section 168A. The QCA Act does not state the weight which must be attached to any particular factor. In the context of assessing the 2014 DAU, we have to take into consideration all the factors listed in section 138(2) as jurisdictional prerequisites for our decision, but with a weighting of each factor we consider is appropriate based on the practical relevance of the factor to our decision.

We have identified below those factors that we consider warrant more weight based on the practical relevance of the factors to our draft decision in regard to WIRP:

- Sections 138(2)(a),(b),(d),(e),(g) and (h) should be given more weight as identified below.
- Sections 138(2)(c) and (f) should be given less weight as these provisions have no practical relevance.

Object of Part 5 of the QCA Act

Section 138(2)(a) of the QCA Act requires us to have regard to, among other matters, the object of Part 5 (in section 69E of the QCA Act) which is set out in Box 1 above. We refer to our consideration of the object of Part 5 in our previous draft decisions.

In the context of the reference tariffs for WIRP, the object of Part 5 would be promoted if, for example:

- the efficient costs of WIRP infrastructure are appropriately reflected in the reference tariffs for access holders
- the efficient costs of WIRP infrastructure are allocated appropriately between the relevant access seeker and access holders
- the pricing principles applied to WIRP infrastructure provide an appropriate level of investment certainty.

Such requirements would promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets.

The legitimate business interests of Aurizon Network

Section 138(2)(b) requires us to have regard to the legitimate business interests of Aurizon Network. In the context of the WIRP pricing arrangements, we consider the legitimate business interests of Aurizon Network will be met where, for example, Aurizon Network is able to recover the efficient costs of providing the infrastructure, including a regulated return on the investment, over the estimated economic life of the asset.

The QCA Act does not require that the interests of an access provider are given priority. Rather, section 138(2) requires that we may approve a draft access undertaking only if we consider it appropriate to do so having regard to all matters listed in paragraphs (a)–(h) of section 138(2). We have to balance these matters, as we consider appropriate, consistent with our weighting of the various matters.

Public interest

Section 138(2)(d) of the QCA Act requires us to have regard to the public interest, including the public interest in having competition in markets. We consider that meeting the public interest requires us to have regard to the need for an efficient and competitive coal industry in Queensland. In this context, we are of the view that the WIRP pricing arrangements should support the continued competitiveness of Queensland's coal mining sector, for both existing and new customers in the Blackwater and Moura systems.

Interest of access seekers and access holders

Section 138(2)(e) of the QCA Act requires us to have regard to the interests of persons who may seek access to the service. We also consider that the rights of existing access holders are relevant under section 138(2)(h), to the extent they are not already access seekers under section 138(2)(e).

For the WIRP pricing arrangements, we must balance the interests of customers who have invested in WIRP infrastructure with those customers who have not (non-WIRP customers). We also have to account for the interests of future access seekers on the Blackwater and Moura systems. We consider the interests of current and future access seekers, as well as access holders, will best be met where:

- the pricing arrangements applied mean that the relevant access holders and access seekers meet the efficient costs of the WIRP infrastructure
- any risk, cost, pricing and take-or-pay implications not considered appropriate for non-WIRP customers to bear are minimised to the extent practicable.

Pricing principles in section 168A of the QCA Act

Section 138(2)(g) of the QCA Act requires us to have regard to the pricing principles in section 168(A). The intent of the pricing principles is to provide a transparent framework for determining price limits, the structure of access charges and dealing with issues of price discrimination. We consider the concept of efficient cost and the allocation of costs particularly relevant for the WIRP pricing arrangements.

Efficient cost

We undertook a detailed analysis of the pricing principles applicable to the 2014 DAU in the context of our draft decision on the MAR published in September 2014. As part of that decision, we considered the concept of 'efficient costs' (section 2.1.2 of that decision). We hold the same view in relation to this draft decision.

Allocation of costs

The appropriate allocation of WIRP costs between WIRP and non-WIRP customers is a key consideration in developing the WIRP pricing arrangements. This is because such allocation will impact on both WIRP and non-WIRP customers and has implications for cross-subsidisation, pricing structures and pricing signals.

The allocation of costs is particularly relevant to our consideration of the pricing principles contained in sections 168A(b) and (c) and section 137(1A)(b) because:

- section 168A(b) of the QCA Act provides that prices should allow for multi-part pricing and price discrimination, when it aids efficiency
- section 137(1A)(b) applies to Aurizon Network as a 'related access provider'¹¹ and requires that the 2014 DAU must include provisions for preventing a related access provider recovering, through the price of access to the service, costs that are not reasonably attributable to the provision of the service
- section 168A(c) applies to Aurizon Network as a 'related access provider' and does not allow it to set terms and conditions that discriminate in favour of the downstream operations of

¹¹ A 'related access provider' is an access provider that not only owns or operates the declared service, but also provides, or proposes to provide, access to the service to itself or a related body corporate.

the access provider, except to the extent the cost of providing access to other operators is higher.

Cost allocation may impact on all of these areas.

Other issues the QCA considers relevant

As part of the matters to which we must have regard under section 138(2) of the QCA Act, we are required by section 138(2)(h) to have regard to any other issues that we consider are relevant. While we have discretion as to these other issues, we must exercise that discretion bona fide and having regard to the policy and purpose of the QCA Act.

Bearing this in mind, we consider the following other issues to be relevant to the proposed WIRP pricing arrangements:

- the interests of access holders
- the historic level and extent of customer engagement by Aurizon Network, including representations made
- historic expectations regarding the appropriate regulatory framework, including the extent to which the pricing principles approved in the 2010 AU should be used as a benchmark for the WIRP infrastructure
- appropriate allocation of risk between different stakeholders (where not already addressed by section 138(2))
- the possibility of shifting existing volumes to WIRP infrastructure
- the need for transparency and certainty—the WIRP pricing approach should be as transparent as practicable and minimise complexity, to ensure all stakeholders have certainty as to how costs are allocated and how access charges are derived
- market conditions—as the CQCN continues to face globally competitive conditions, a balance has to be struck between preserving individual stakeholders' business interests and promoting the public interest (i.e. ensuring the CQCN's medium- to long-term competitive position in the global coal markets).

3 HISTORICAL CONTEXT AND IMPLICATIONS

In forming a view on the appropriateness of the pricing arrangements proposed for WIRP train services in the 2014 DAU, we consider it important to understand, and have regard to, the sequence of events leading up to this point in the WIRP process.

Stakeholders have differing views on the appropriate pricing arrangements to apply, in part due to various representations made by Aurizon Network to WIRP and non-WIRP customers about the need for infrastructure upgrades to the Blackwater and Moura systems. In addition, Aurizon Network's customer engagement process does not appear to have placed much emphasis on matters of pricing and cost allocation between WIRP and non-WIRP users.

Our assessment has considered key threshold issues that have arisen in the context of WIRP, including the extent to which we should:

- have regard to the previous regulatory pre-approval of part of the WIRP scope in determining the appropriate allocation of costs between users*
- have regard to the WIRP commercial arrangements (in particular, the approved access conditions) in considering the pricing arrangements to apply*
- consider any expectations that pricing principles for the WIRP projects should be based on the 2010 AU rather than the 2014 DAU.*

As discussed further in this chapter, we have formed the view that:

- although customer endorsement of the 2008 CRIMP occurred, the endorsement was negated by subsequent changes in scope and circumstances and is therefore not determinative of the allocation of WIRP capital costs under the 2014 DAU*
- it would not be appropriate to exclude consideration of the WIRP access conditions when forming our draft decision*
- while the 2010 AU provisions relating to WIRP pricing are relevant to our consideration of the reference tariffs for WIRP under the 2014 DAU, we do not consider that these provisions are determinative. Aspects of Aurizon Network's proposed 2014 DAU, as well as our proposed amendments (as set out in our January 2015 Draft Decision), are relevant considerations in our assessment of WIRP pricing under the 2014 DAU.*

3.1 Introduction

Aurizon Network submitted two separate proposals in relation to the pricing arrangements for WIRP (see Sections 1.3.1 and 1.3.2 of this paper). One of these was formally submitted under the 2014 DAU process. The other was submitted pursuant to a process under the 2010 AU.

These proposals apply different assumptions (e.g. cost allocations, volumes, etc.) and regulatory pricing principles when assessing prices for WIRP train services.

Stakeholders raised a range of diverse views in response to these pricing proposals and do not agree on which factors are relevant and the weighting that should be given to them in determining the pricing arrangements.

Aurizon Network has, in some instances, used 2010 AU processes to support its application of a particular approach or assumption. Box 2 provides a brief summary of these processes.

Box 2: Processes relevant to the historical context of WIRP

Regulatory pre-approval of the scope of capital projects

The 2008 and 2010 undertakings included arrangements for Aurizon Network to gain regulatory pre-approval of the scope of capital projects for inclusion into its regulatory asset base. To gain pre-approval, Aurizon Network was required to:

- prepare a Coal Rail Infrastructure Master Plan (CRIMP)— setting out planned capital works for each central Queensland coal system required to meet capacity demands in the short to medium term, including preliminary cost estimates. The CRIMP also details particular capital projects for which Aurizon Network is seeking customer endorsement¹²
- seek customer endorsement from affected customers — affected customers are given information and the opportunity to vote for or against capital projects detailed in the CRIMP. Customer endorsement is received if at least 60 per cent of customers accept the scope of the capital project/s (with votes weighted according to the share of contracted tonnage the customer holds)¹³
- seek regulatory pre-approval of customer endorsed projects—if regulatory pre-approval is granted the scope of projects is taken as given. Thereafter we only assess the prudence of cost and standard of works associated with that scope before accepting those capital expenditure projects into Aurizon Network's regulatory asset base. This occurs as part of an ex post capital expenditure approval process.¹⁴

Between 2008 and 2011, Aurizon Network developed and released three CRIMPs and sought customer endorsement and regulatory pre-approval of capital expenditure projects. In particular, the 2008 CRIMP contained seven Blackwater duplications that formed part of WIRP and the scope of these projects was endorsed by Blackwater customers and approved by the QCA.

Arrangements for seeking access conditions

The 2010 AU includes arrangements so that Aurizon Network can seek 'access conditions' from access seekers to cover the additional risks associated with providing access if it:

- makes a significant investment (i.e. an investment exceeding \$300 million)¹⁵
- believes this investment has financial risks not already mitigated by existing arrangements (i.e. via access agreements, take-or-pay arrangements or insurance and other financial instruments).

Aurizon Network began discussions with WIRP users regarding access conditions for WIRP in 2010. WIRP users agreed to Aurizon Network's access conditions. Against a background of agreement between Aurizon Network and WIRP users, they were subsequently approved by us in May 2012. These access conditions are contained in WIRP deeds between Aurizon Network and the WIRP users.

This chapter reviews the historical context to the proposed reference tariffs for WIRP, including any representations made regarding the appropriate allocation of WIRP costs and risks between users (Section 3.2).

This chapter also reviews whether the reference tariffs for WIRP proposed under the 2014 DAU are appropriate under section 138(2) of the QCA Act or, for example, should reflect the pricing principles in the 2010 AU (when the WIRP arrangements were negotiated and executed), or a combination of both the 2014 DAU and 2010 AU (Section 3.3).

3.1.1 Key WIRP events and milestones

In April 2015, we approved a transitional reference tariff for 2014–15 to apply to WIRP train services under the 2010 AU (see Section 1.3.2).¹⁶ The first railings to WICET occurred in late April 2015.

¹² 2008 AU, Schedule FB, cl. 2.2.1; 2010 AU, cl. 11.2

¹³ 2008 AU, Schedule FB, cl. 2.2.2; 2010 AU, Schedule A, cl. 3.2

¹⁴ 2008 AU, Schedule FB, cl. 2.2(a)(ii) and 2.3.2(b)(i); 2010 AU, Schedule A, cl. 3.1

¹⁵ 2010 AU, Clause 6.5.2.

Box 3 contains a summary of key WIRP events leading up to this point. More details are provided in **Appendix A**.¹⁷

Box 3: Summary of key WIRP events

Regulatory pre-approval of the scope of capital projects

- 2008 CRIMP (October) – Aurizon Network proposed seven duplications to be completed by 2012. Aurizon Network received customer endorsement in December 2008, and QCA regulatory pre-approval in February 2009.
- 2009 (October) CRIMP – Aurizon Network revised the completion timing of the duplications to 2013.¹⁸
- 2010 (October) CRIMP – Aurizon Network said early indications suggested three duplications were required to accommodate WICET Stage 1, with the remaining four tabled potentially for the future.¹⁹
- 2010 (December) – Gladstone Coal Export Executive (GCEE), representing existing users, was advised that requirements and timing for Blackwater duplications in the 2008 CRIMP were no longer relevant.

Access conditions arrangements

- Late 2010 – Aurizon Network commenced discussions with WIRP users regarding access conditions.
- 2011 (May) – Aurizon Network provided us with an initial report on WIRP access conditions. It detailed the access conditions it was seeking to obtain from WIRP users (including a WIRP fee) to compensate it for additional risks associated with WIRP.
- 2011 (September) – Aurizon Network and WIRP users entered into commercial arrangements, including to pay the WIRP fee.
- 2012 (May) - Against a background of agreement between Aurizon Network and WIRP users, QCA approved Aurizon Network's access conditions, including the WIRP fee.

Aurizon Network WIRP pricing proposals

- 2013 (April) 2013 DAU submission – Aurizon Network proposed tariffs for WIRP train services that socialised costs across the Blackwater and Moura systems.
- 2014 (August) 2014 DAU submission – Aurizon Network provided a separate guidance note on its treatment of WIRP in its 2013 DAU and 2014 DAU submissions. Its proposed capital allocation to existing Blackwater customers was equivalent to one-seventh of the total cost of the duplications.
- 2014 (December) WIRP pricing proposal – Aurizon Network proposed costs for the Blackwater duplications segment be shared equally between WIRP and non-WIRP users and based its WIRP pricing proposal on the 2010 AU, not the 2014 DAU.

3.2 Relevance of historical events in the context of WIRP

As an initial step in developing our approach, we reviewed the relevance of all previous arrangements relating to WIRP, including the key events identified above. In particular we consider the following in the sections below:

- relevance of CRIMP in the context of WIRP
- relevance of WIRP access conditions.

In doing so, we sought to identify the extent to which historical representations had been made regarding the appropriate allocation of WIRP costs and risks between users. We believe that

¹⁶ Aurizon Network's December 2014 WIRP pricing proposal included transitional tariffs for WIRP for 2014–15 which we approved in April 2015. Aurizon Network's 2015 DAAU proposal then extended this period so reference tariffs, including the transitional tariff for WIRP, would apply until February 2016. We approved this in June 2015.

¹⁷ This timeline was developed via publicly available information and information we requested from Aurizon Network and WIRP users during the consultation process.

¹⁸ Aurizon Network, 2009 CRIMP: 29

¹⁹ Aurizon Network, 2010 CRIMP: 38

such representations are a relevant issue under section 138(2)(h) of the QCA Act, underpinning such issues as investment and price certainty.

3.2.1 Relevance of CRIMP in the context of WIRP

Aurizon Network proposal

Total WIRP forecast capital costs include \$424.8 million relating to duplications to the Blackwater system.²⁰

Aurizon Network said the Blackwater duplications were deemed to be prudent and accepted by incumbent Blackwater system customers as part of the 2008 CRIMP and, as a result, received scope pre-approval from the QCA. Aurizon Network noted both these approvals were granted in the absence of the additional capacity created by WICET.²¹

Aurizon Network also claimed the request from the Gladstone Coal Exporters Executive (GCEE) in December 2010 to recommence the Blackwater duplication project reinforced the view the duplications remained prudent in the absence of WIRP train services.²²

Stakeholders' comments

The views of stakeholders differed between WIRP customers and non-WIRP customers.

WIRP customers said it was relevant there were pre-existing requests by non-WIRP customers to proceed with the duplications and accelerate the delivery, indicating that non-WIRP Blackwater users considered the Blackwater duplications would benefit them.²³

Non-WIRP customers opposed Aurizon Network's reference to the 2008 CRIMP customer vote as a justification for allocating WIRP capital costs to existing non-WIRP Blackwater customers because:

- the Blackwater duplications were previously endorsed by existing Blackwater system users (as part of the 2008 CRIMP process). At that time, Aurizon Network produced capacity modelling demonstrating the duplications were required in the absence of WIRP
- Aurizon Network made subsequent representations conflicting with this. For instance, as part of the WIRP access conditions process, Aurizon Network produced capacity modelling demonstrating the duplications would not be required in the absence of WIRP.²⁴

Stakeholders also did not agree the GCEE correspondence supported the view that existing users regarded the Blackwater duplications as prudent in the absence of WIRP. Idemitsu suggested the purpose of the GCEE correspondence was rather to request the sooner completion of committed projects to reduce the adverse impacts of construction.²⁵ Anglo American said the context of the letter is not clear.²⁶

²⁰ Aurizon Network, 2014(g): 7

²¹ Aurizon Network, 2014(g): 8

²² Aurizon Network, 2014(g): 9

²³ WIRP Users, 2014 DAU, sub. no. 68: 4

²⁴ BMA, 2014 DAU, sub. no. 23: 2; BMA, sub. no. 67: 1, Anglo American, sub. no. 72: 3, BMA, sub. no. 67: 1, Idemitsu, 2014 DAU, sub. no. 71: 1–2

²⁵ Idemitsu, 2014 DAU, sub. no. 71: 2

²⁶ Anglo American, sub. no. 72: 4

QCA analysis and draft decision

Based on the available information, we do not consider existing users' endorsement of the Blackwater duplications as part of the 2008 CRIMP is a determinative factor in forming our view on the appropriate allocation of WIRP costs to existing Blackwater users.

We recognise existing users of the Blackwater system endorsed the scope of seven mainline duplications as part of the 2008 CRIMP process. Nevertheless, in the two-year period following the 2008 CRIMP, circumstances and assumptions on which the 2008 CRIMP had been developed significantly changed. Aurizon Network amended the timing and number of Blackwater duplications required. It did this on numerous occasions and within various forums, based on the results of updated analysis and capacity modelling it had undertaken.

For example, in 2010, Aurizon Network indicated the assumptions underlying the 2008 CRIMP were no longer relevant and updated modelling was undertaken that showed a reduced requirement for below rail infrastructure based on significantly increased payloads for trains using Blackwater.²⁷ In the 2010 CRIMP, Aurizon Network expected only three Blackwater duplications were required to accommodate WIRP²⁸, with a potential for the remaining four Blackwater duplications in the future if Gladstone Ports Corporation decided to proceed with its desired increase in exports at the RG Tanna Coal Terminal from 69 mtpa to 75 mtpa.²⁹

In light of the available information, following changes in scope we understand existing Blackwater customers were not availed the opportunity to vote again to endorse the new scope and the assumptions on which it was based. In our view this is contrary to the interests of all or some of the relevant access holders and access seekers (sections 138(2)(e) and (h) of the QCA Act) who would have been entitled, through the voting process, to express their view on Aurizon Network's revised proposals.

Indeed, we consider the fact that Aurizon Network did not conduct subsequent voting processes based on information improved over the period since the 2008 and subsequent CRIMPs is counter to the requirement to ensure efficient investment in the CQCN and therefore does not align with the object of the access regime and the public interest (sections 69(e) and 138(a) and (d) of the QCA Act).

Accordingly we consider that customer endorsement of the 2008 CRIMP was negated and is no longer determinative as the basis for forming our view on allocating WIRP costs. We consider that this position does not conflict with Aurizon Network's legitimate business interests as it can still recover the efficient costs of providing the infrastructure, including a regulated return on the investment commensurate with the regulatory and commercial risks involved, over the estimated economic life of the asset.

²⁷ Letter from Queensland Treasurer to GCEE, November 2010; Letter from Aurizon Network to GCEE, May 2010.

²⁸ Aurizon Network 2010 CRIMP: 38

²⁹ Aurizon Network 2010 CRIMP: 43

Draft decision

3.1 Our draft decision is that although customer endorsement of the 2008 CRIMP occurred, the endorsement was negated by subsequent changes in scope and circumstances and is therefore not determinative of the allocation of WIRP capital costs under the 2014 DAU.

3.2.2 Relevance of WIRP access conditions

Aurizon Network proposal

In September 2011, Aurizon Network and WIRP access seekers agreed upon a set of access conditions required by Aurizon Network for it to expand its rail network to provide sufficient capacity to support WICET Stage 1. The detailed terms of the agreed access conditions were contained in individual deeds (WIRP deeds) between Aurizon Network and each of the WIRP access seekers.

The WIRP deeds include a fee (the WIRP fee) applied to each WIRP access seeker's share of the total cost of the WIRP project. The WIRP fee was based on a set proportion of the cost of the Blackwater duplications, and allocated to access seekers accordingly.³⁰

Aurizon Network did not consider the access conditions to be relevant to WIRP pricing arrangements. Aurizon Network said this is because the access conditions are designed to mitigate its exposure to 'additional risks'³¹ and, in the case of WIRP:

- the access condition is in the form of an incentive based fee (WIRP fee) linked to the timing, cost and delivery of the installed capacity³²
- the WIRP fee is paid by WIRP customers only, and the arrangements do not allow Aurizon Network to pass the WIRP fee through to other access holders.³³

In addition, Aurizon Network said the existence of access conditions does not preclude CQCN infrastructure costs being shared:

*The risk of sharing CQCN infrastructure costs between users is an accepted part of the standard regulatory framework. In the context of WIRP, this risk must be kept separate and distinct from any discussion around access conditions.*³⁴

Stakeholders' comments

Stakeholders had different views on the relevance of access conditions to WIRP pricing and cost allocation.

Non-WIRP customers said the commercial arrangements, particularly the access conditions, were relevant. They said that existing customers should not bear greater risks and in particular:

- Vale said that a pricing decision to socialise the WIRP infrastructure is likely to reduce the optimisation, asset stranding and credit risk to a level consistent with the regulated environment and would therefore be inconsistent with the previous regulatory decision to approve WIRP access conditions³⁵

³⁰ Aurizon Network, 2014(g): 15, 19

³¹ Appendix B provides a summary of the additional risks associated with WIRP, as stated by Aurizon Network.

³² Aurizon Network, 2014(g): 14–15

³³ Aurizon Network, 2014(g): 15

³⁴ Aurizon Network, 2014(g): 15

³⁵ Vale, 2014 DAU, sub. no. 54: 2–3

- RTCA said Aurizon Network negotiated higher rates of return to have the WIRP infrastructure underwritten and consequently undertaken, yet is seeking to mitigate/transfer risk to a larger pool of users by proposing a significant portion of the investment be socialised³⁶
- BMA said existing customers must not bear any of the commercial risk or cost associated with expansions of the network, including the default or asset stranding risk of a project commercially negotiated between Aurizon Network and expanding users³⁷
- Idemitsu said a review of the reasonableness of sharing risks related to users of WICET across the system is required. If Aurizon Network has been compensated for this risk through its access conditions, then transferring this risk to all users should not be supported.³⁸

In contrast, WIRP customers supported Aurizon Network's view that WIRP access conditions were not a relevant factor in determining the cost allocation, nor did their existence prevent capital costs being allocated to non-WIRP customers. Glencore said the asset stranding and optimisation risk to Aurizon Network would not be affected by socialisation. In addition, it said the credit risk addressed in the WIRP access conditions related to the recovery of the WIRP fee rather than general access charges.³⁹

WIRP customers said the WIRP fee provided Aurizon Network with the incentive to install necessary capacity for both pre-existing and genuine WIRP requirements. Without WIRP customers agreeing to pay the WIRP fee, existing users would not have received these benefits, and WIRP would not have been commissioned.⁴⁰

QCA analysis and draft decision

In principle, we agree with Aurizon Network's position that the existence of access conditions does not necessarily preclude the cost of assets from being socialised. Pricing principles can still be applied to determine how WIRP capital costs should be recovered from new and existing users. In addition, there are no arrangements in the 2010 AU preventing the socialisation of assets where access conditions apply.

In this instance, however, Aurizon Network and WIRP users agreed additional risks were involved in developing the WIRP project and that Aurizon Network should be compensated for this via access conditions (a WIRP fee). We consider this factor relevant in forming our view on which WIRP costs should be allocated to WIRP users.

In coming to this view we note both Aurizon Network and WIRP users have decided that it was in their individual interests to agree to the WIRP fee. By contrast, we consider that it is not immediately clear what is in the interests of non-WIRP users given the presence of the WIRP fee and the complexities in developing WIRP pricing.

As such we are of the view that when developing our draft decision on WIRP pricing and balancing the interests of all relevant access seekers, access holders and the public interest (ss. 138(2)(d), (e) and (h) of the QCA Act), it would not be appropriate to exclude an assessment of the WIRP access conditions when forming our decision. Further, we see no reason why this

³⁶ RTCA, 2014 DAU, sub. no. 73: 2; Asciano, 2014 DAU, sub. no. 69: 8

³⁷ BMA, 2014 DAU, sub. no. 67: 1

³⁸ Idemitsu, 2014 DAU, sub. no. 71: 2

³⁹ Glencore, 2014 DAU, sub. no. 50: 3–4

⁴⁰ New Hope, 2014 DAU, sub. no. 66: 2

would conflict with Aurizon Network's legitimate business interests (section 138(2)(b) of the QCA Act).

Draft decision

3.2 Our draft decision is that it would not be appropriate to exclude consideration of the WIRP access conditions when forming our draft decision.

3.3 Applicable access undertaking for regulatory pricing principles

3.3.1 Aurizon Network proposal

Aurizon Network has provided us with two separate documents outlining their proposed pricing and revenue treatments for WIRP train services:

- in August 2014, a submission that outlines its revenue and pricing treatment of WIRP in its 2014 DAU submission
- in December 2014, a proposal for 'transitional' tariffs for WIRP train services pursuant to clause 6.4.2 of the 2010 AU.

Under these proposals, Aurizon Network applied different assumptions (e.g. cost allocations, volumes, etc) and methodologies when assessing prices for WIRP train services.

Aurizon Network's proposed methodologies for each of its two separate pricing proposals are described at a high level below. The succeeding chapters address Aurizon Network's application of these methodologies along with its assumptions.

We emphasise that our analysis is occurring under the 2014 DAU process, so we are considering whether the reference tariffs for WIRP for the 2014 DAU identified by Aurizon Network in its 2014 DAU result in a draft access undertaking that we consider is appropriate to approve having regard to the matters under section 138(2) of the QCA Act.

However, we consider that the December 2014 proposal under the 2010 AU provides relevant context to our analysis of WIRP under the 2014 DAU. Moreover, we consider a relevant issue under section 138(2)(h) of the QCA Act are historic expectations regarding the appropriate regulatory framework, including the extent to which the pricing principles approved in the 2010 AU should be used as a benchmark for the WIRP infrastructure.

August 2014 submission

In its August 2014 submission, Aurizon Network said that its proposed pricing treatment for WIRP under its 2014 DAU was guided by the 'pricing limit' principle proposed under the same draft access undertaking. Aurizon Network's 2014 DAU required the access charges to be set (2014 DAU, cl. 6.3.2(a)):

- (i) *no less than the level that will recover the expected Incremental Costs of providing Access ...; and*
- (ii) *no more than the level that will recover the expected Stand Alone Cost of providing Access ...*

Aurizon Network said that these bounds allowed for a number of pricing outcomes and it had sought a reasonable outcome that it considered balanced the interests of different stakeholders.

In the submission, Aurizon Network applied the 'socialisation' test as proposed in its 2014 DAU to determine whether WIRP expansion costs should be socialised with existing system tariffs for

the Blackwater and Moura systems. Clause 6.2.4(i) of Aurizon Network's proposed 2014 DAU required the comparison, on a \$/nt basis, between the existing system reference tariff (without the expansion) and the same tariff once incremental costs and volumes arising from the expansion are socialised within the system.⁴¹

Aurizon Network said the outcome of this socialisation test was that the 'socialised' tariffs for both the Blackwater and Moura systems would be lower (on a \$/nt basis) than the respective existing system reference tariffs. Aurizon Network said this analysis indicated that WIRP should be socialised within the Blackwater and Moura systems. As a result, Aurizon Network's 2014 DAU submission proposed 'socialised' tariffs for both the Blackwater and Moura systems.⁴²

December 2014 pricing proposal

In the December 2014 pricing proposal, Aurizon Network applied the 2010 AU provisions for pricing WIRP train services, rather than the provisions in Aurizon Network's 2014 DAU. Aurizon Network said that WIRP customers supported the application of the 2010 AU provisions for setting reference tariffs for WIRP train services.

With respect to the application of the 2010 AU provisions under its December 2014 proposal, Aurizon Network said:

- the investment decisions in relation to WIRP and WICET had relied on the 2010 AU provisions, hence it would not be appropriate to retrospectively apply Aurizon Network's proposed 2014 DAU provisions to pricing WIRP train services
- applying the 2010 AU provisions to WIRP pricing is consistent with the existing approach to assessing the prudence of capital expenditure, where the assessment is based on information available to the parties at the time of making the decision
- the final form of the 2014 DAU provisions is not known, and the 2010 AU provisions will still be in effect when WIRP train services commence in 2014–15.

Aurizon Network applied a specific provision of the 2010 AU, which required that the applicable reference tariff for a new coal-carrying train service would be on an \$/ntk basis, as stated in 2010 AU (Schedule F, Part B, cl. 4.1.2):

In order to reflect the requirements of Subclause 4.1.1, the Reference Tariff applicable for a new coal carrying Train Service will be the higher of (on a \$/ntk basis):

- (a) *the Reference Tariff for the relevant Individual Coal System Infrastructure; or*
- (b) *the sum of the new coal carrying Train Service's Private Incremental Costs (if any), the Incremental Costs of using any Rail Infrastructure specifically related to the new coal carrying Train Service and the required minimum Common Cost contribution ...*

provided that the Access Charge payable to QR (now Aurizon) Network for the operation of that new coal carrying Train Service is calculated as the applicable Reference Tariff less the Private Incremental Costs (if any).

For ease, in this draft decision this provision is referred to as Subclause 4.1.2.

Subclause 4.1.2 was applied to WIRP train services in the Blackwater and Moura systems, but not to the NCL train service, which originates from the Queensland Rail Network (Aurizon Network has proposed an alternative reference tariff for this train service).

⁴¹ Clause 6.2.4(i) has references to the Highest Reference Tariff. In cases where there is no existing expansion tariff associated with the system, the system reference tariff is the Highest Reference Tariff.

⁴² Aurizon Network, 2014 DAU, sub. no. 6: 6

Aurizon Network said that, consistent with the requirements of Subclause 4.1.2, a socialised system reference tariff should be applied to WIRP train services in the Blackwater system, and an incremental reference tariff (i.e. a system premium on top of the Moura system reference tariff) should apply in the Moura system.

3.3.2 Stakeholders' comments

Again, the stakeholder views differed between WIRP and non-WIRP users.

The WIRP users agreed with Aurizon Network's proposal to apply the 2010 AU pricing principles given WIRP customers had relied on these principles in making their initial investment decisions and all related and consequential investment decisions.⁴³ WIRP users said WIRP customers assumed that WIRP costs would be socialised since there was no socialisation test in the 2010 AU. While a socialisation test was proposed in Aurizon Network's 2014 DAU, the relevant access seekers would be informed of the results of this test prior to signing access agreements.⁴⁴

Cockatoo Coal said due consideration should be given to the regulatory assumptions that underpinned investment decisions for the expansion and potential mines. It said WIRP customers were not provided the opportunity to consider the contents of a pricing proposal at the pre-feasibility stage under the proposed UT4 expansion pricing approach and so the retrospective application of new regulatory provisions might create an untenable degree of uncertainty and investment risk for expanding users. New Hope agreed that parties to the WIRP Deed believed that the 2010 AU would apply, including that the pricing principles and Schedule F would be used to price WIRP train services.⁴⁵

Further, regarding the specific approach to incremental costs, WIRP users said the mainline expansions are fully integrated with existing infrastructure and therefore not specific to WIRP volumes. As a result, the associated incremental costs are not 'specifically related to' the WIRP train services and therefore not relevant for the purposes of the assessment of the appropriate reference tariff to apply to WIRP users under Subclause 4.1.2.⁴⁶

In contrast to Aurizon Network and WIRP users, non-WIRP customers of the Moura and Blackwater systems, such as Anglo American and BMA, had an opposing view regarding the role of socialisation. They did not consider they should bear the costs and associated risk given the fact that the utilisation of WIRP infrastructure would be lower than initially expected in the short to medium term.⁴⁷

Anglo American and Asciano said the proposed WIRP pricing should be consistent with the expansion pricing process decided under UT4.⁴⁸

3.3.3 QCA analysis and draft decision

As identified above, our analysis is occurring under the 2014 DAU process, so we are considering whether the reference tariffs for WIRP identified by Aurizon Network under the 2014 DAU result in a draft access undertaking that we consider is appropriate to approve having regard to the matters under section 138(2) of the QCA Act.

⁴³ WIRP Users, 2014 DAU, sub. no. 68: 2

⁴⁴ WIRP Users, 2014 DAU, sub. no. 68: 2–3

⁴⁵ Cockatoo Coal, 2014 DAU, sub. no. 70: 2

⁴⁶ WIRP Users, 2014 DAU, sub. no. 68: 3–4

⁴⁷ Anglo American, 2014 DAU, sub. no. 72: 3; BMA, 2014 DAU, sub. no. 67:2

⁴⁸ Anglo American, 2014 DAU, sub. no. 95: 36; Asciano, 2014 DAU, sub. no. 69: 4

In doing so, we have considered submissions from some stakeholders that the pricing principles set out in the 2010 AU should apply rather than those set out in the 2014 DAU. We have also considered arguments based on historic expectations.

Ultimately, while we recognise the relevance of the 2010 AU provisions to WIRP pricing, we do not consider that these provisions are determinative in this context. We do not consider that the pricing principles set out in the 2010 AU should apply rather than those set out in the 2014 DAU.

As set out in more detail below, the factors that informed our view are:

- the applicability of Subclause 4.1.2, Schedule F, Part B of the 2010 AU (referred to from herein as Subclause 4.1.2) to WIRP train services
- the general intent of the 2010 AU and 2014 DAU pricing principles.

Applicability of Subclause 4.1.2

We do not consider the new WIRP train services should be priced in accordance with Subclause 4.1.2. In our view, Subclause 4.1.2 should not be applied in the WIRP context as it was not designed for such a purpose.

Broad applicability

Subclause 4.1.2 was approved by us in the context of a new train service (an origin–destination pair) with individual coal system infrastructure specifically related to the new train service.⁴⁹ It was not envisaged at the time that this test would be applied for major step changes in capacity such as the integrated duplications associated with WIRP.

There is potentially a significant cost and risk difference in providing access for a single train service by way of a mine-specific spur as compared to a combination of new train services arising from a major expansion of the network. In the latter case, if a train service subsequently under-railed, there may be a significant adverse impact on other users. Given this we consider that strict application of Subclause 4.1.2 to establish prices for WIRP train services without consideration of other relevant factors disregards the magnitude of costs and risks associated with the project.

In particular, we consider it unreasonable for the economic viability of a mine that is already operating to be adversely impacted by a material increase in access charges resulting from an expansion triggered by other users. Existing users should, to the extent practicable, be confident of a relatively stable risk and access charge profile over time.

As a result, we do not consider the application of Subclause 4.1.2 to a major expansion such as WIRP would be appropriate when having regard to the statutory criteria that we are required to consider under section 138(2) the QCA Act.

Specific issues in interpretation

WIRP customers have suggested there would be a lack of clarity if Subclause 4.1.2 were to apply to the interpretation of the term 'specifically related to' with respect to the concept of incremental costs. As a result, they have questioned whether incremental mainline costs are relevant for the purposes of the test outlined in Subclause 4.1.2.

⁴⁹ QCA, 2009: 162–163

In its 2013 DAU submission, Aurizon Network also suggested that there was uncertainty among stakeholders with respect to the meaning of incremental costs in the context of applying Subclause 4.1.2 to WIRP.⁵⁰ In particular, Aurizon Network said there was confusion over whether 'specifically related to' referred to only those expansion costs for infrastructure unique to the new train service, or whether it also includes an allocation of expansion costs for common-use infrastructure attributable to the new train service.⁵¹

In our view, the difficulty Aurizon Network and WIRP users are experiencing in interpreting 'specifically related to' in the context of applying Subclause 4.1.2 to WIRP is because this clause was not designed or intended to be applied in the context of a major expansion. Our reasoning is outlined below.

In its 2013 DAU submission, Aurizon Network explained the application of the 'specifically related to' as:

This requirement is based on an expectation that AT2 is representative of the mainline expansion costs and therefore not within the construct of incremental costs (as it is a cost that is common across multiple users).⁵²

This is broadly consistent with our interpretation of the application of Subclause 4.1.2 in our approval of this test in our Draft Decision on the 2009 DAU:

... the incremental cost used in the system test calculations is based on the asset value and operating cost of the spur, rail loop and other infrastructure which is specifically dedicated to a particular mine. It does not encompass any amount for the train paths on the shared or mainline part of the network, which are required to transport the mine's coal to its destination. Therefore, if train services only paid their incremental cost, they would 'free ride' on the cost of the shared network.

... QR Network's proposed [Common Cost Contribution (CCC)] threshold in the 2009 DAU provides for a mine to pay at least a minimum portion of the shared infrastructure cost, which is difficult or impossible to differentiate between individual users. This means that, in effect, the minimum CCC is a way of estimating those incremental costs that relate to a train service's use of the mainline segments of a coal system.⁵³

In this respect, we have concerns that the minimum contribution to common costs (CCC) as calculated in accordance with Subclause 4.1.2 would reflect the incremental costs associated with WIRP if these costs were not included as part of incremental costs 'specifically related to the new coal carrying Train Service'. We consider that this issue highlights the fact that Subclause 4.1.2 was not designed or intended to be applied in the context of a major expansion, so is not an appropriate alternative to the pricing proposal for the 2014 DAU.

Intent of the 2010 AU and 2014 DAU provisions

We consider there are alternative approaches to Subclause 4.1.2 that address issues associated with WIRP pricing arrangements and are consistent with the 2010 AU pricing principles and the QCA Act.

A key pricing principle common to both the 2010 AU and 2014 DAU (as well as under our proposed amendments to the 2014 DAU) is the pricing limit principle, which states that the relevant access charge for a train service will at least cover the expected incremental costs of

⁵² Aurizon Network, 2013 DAU, sub. no. 2: 197

⁵² Aurizon Network, 2013 DAU, sub. no. 2: 197

⁵² Aurizon Network, 2013 DAU, sub. no. 2: 197

⁵³ QCA, 2009: 163

providing access for that train service. Both the 2010 AU and proposed 2014 DAU define 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.

This definition applies the concept of avoidable costs to address how a floor price can be established for new train services that require an expansion.

This treatment of incremental costs for a major expansion was reflected in Aurizon Network's 2013 DAAU pricing proposal for Goonyella to Abbot Point Expansion (GAPE) train services, where it was proposed that the incremental costs associated with GAPE infrastructure be allocated to expanding customers. This approach is also consistent with the principles proposed by Aurizon Network for the expansion pricing framework in the 2014 DAU.

This provides a precedent regarding the treatment of incremental costs for a major expansion under the 2010 AU that does not relate to Subclause 4.1.2.

Aurizon Network said that this precedent does not apply to WIRP as there were different considerations for GAPE pricing including:

- as part of GAPE negotiations, it was agreed that separate revenue and take-or-pay caps would apply to GAPE train services
- pricing principles were consistent between UT2 (when the GAPE project was endorsed) and UT3 (when the GAPE Draft Amending Access Undertaking (DAAU) was approved).⁵⁴

However, we do not consider Aurizon Network's suggestion that these factors differentiate GAPE from WIRP to be compelling. With regard to the first factor, the outcome of negotiations between Aurizon Network and expanding GAPE customers was not a key consideration in accepting the development of a separate GAPE system and tariff. We considered this a reasonable and appropriate approach in our approval of the GAPE DAAU because the proposed tariff was largely based on the incremental costs of the GAPE infrastructure, and avoided the sharing of GAPE costs with other users that did not benefit from the GAPE infrastructure.⁵⁵ With regard to the second factor, we do not consider that the pricing principles under the 2010 AU (when WIRP was endorsed) and 2014 DAU are inconsistent with each other in the manner suggested by Aurizon Network.

In our view, the approved GAPE pricing arrangements in fact provide a precedent that could appropriately be applied to the proposed WIRP pricing arrangements as the GAPE expansion has several similar characteristics, including that it involves a substantial increase in capacity with a ramp-up period.

We also consider some of the issues addressed in Aurizon Network's 2014 DAU (as well as our proposed amendments) are highly relevant to WIRP pricing arrangements and may lead to a better pricing outcome for all parties. These issues include:

- assessing the impact on existing users (in terms of expected access charge) of an expansion triggered by other users

⁵⁴ Aurizon Network, 2014(g): 11

⁵⁵ QCA, 2013(f): 20

- the take-or-pay risk for existing users if forecast expansion volumes fail to materialise
- determining whether a common cost contribution should apply for expanding users.

In summary, we are of the view that we are under no obligation to apply Subclause 4.1.2 when considering our draft decision for WIRP pricing. We note the GAPE expansion pricing process under the 2010 AU did not adopt such an approach. Overall, we do not consider that injudicious adherence to a single clause in the 2010 AU would be appropriate given the range of factors we are required to have regard to under section 138(2) of the QCA.

Draft decision

3.3 Our draft decision is that while the 2010 AU provisions relating to WIRP pricing are relevant to our consideration of the reference tariffs for WIRP under the 2014 DAU, we do not consider these provisions are determinative, particularly as our focus is on assessing the 2014 DAU.

3.4 Conclusion

In summary our conclusions are that:

- although customer endorsement of the 2008 CRIMP occurred, the endorsement was negated by subsequent changes in scope and circumstances and is therefore not determinative of the allocation of WIRP capital costs under the 2014 DAU
- it would not be appropriate to exclude consideration of the WIRP access conditions when forming our draft decision
- while the 2010 AU provisions to WIRP pricing are relevant to our consideration of the reference tariffs for WIRP under the 2014 DAU, we do not consider these provisions determinative, particularly as our focus is on assessing the 2014 DAU.

4 WIRP COSTS AND VOLUMES

Aurizon Network's August 2014 guidance note set out its proposed approach to allocating costs and volumes to WIRP train services under the 2014 DAU. In December 2014, Aurizon Network submitted an updated WIRP pricing proposal that set out a different approach to allocating costs and volumes to WIRP train services under the 2010 AU.

In this chapter we assess the appropriateness of Aurizon Network's proposal to allocating costs and volumes between WIRP and existing customers under the 2014 DAU, having regard to the factors set out in section 138(2) of the QCA Act. We also develop our proposed WIRP costs and volumes for analysis of WIRP pricing options.

For completeness, we have also undertaken the same analysis for Aurizon Network's proposal under the 2010 AU in December 2014.

Aurizon Network proposed in its 2014 DAU to allocate one-seventh of capital costs to the Blackwater non-WIRP customers, and revised this allocation to 50 per cent in its December 2014 update. Our draft decision is to refuse to approve Aurizon Network's proposed capital cost allocation for pricing purposes. Instead, we propose that no capital costs be allocated to existing Blackwater users.

Our draft decision is to refuse to approve Aurizon Network's proposed allocation of operating and maintenance costs to WIRP train services in its 2014 DAU proposal. Instead, we propose to use the operating and maintenance costs for 2015–16 and 2016–17 proposed by Aurizon Network in December 2014.

Further, our draft decision is to adopt the forecast volumes for WIRP and non-WIRP train services consistent with Energy Economics' forecasts with an adjustment to cap WIRP volumes to contracted volumes.

Appendix C provides a summary of our proposed changes to modelling assumptions.

4.1 Introduction

Similar to the 2010 AU, Aurizon Network's 2014 DAU (and our proposed amendments to it) proposes that the access charges for new train services should reflect at least the incremental costs of providing access for the new train services. Setting the price of a new train service at full incremental cost means that:

- pricing for expanding users is cost-reflective and consistent with the pricing limits principle in both the 2010 AU and the 2014 DAU
- the financial impact on existing users of an expansion triggered by expanding users is minimised.⁵⁶

In the case of WIRP, which involves an expansion integrated with the existing network and volumes substitutable between existing and new train services, incremental costs and volumes are not apparent. In this chapter, we consider the options for allocating costs and volumes to

⁵⁶ Under the existing take-or-pay regime, existing users may still bear part of the costs of an expansion even if expanding users pay a system premium (reflecting higher incremental costs) in addition to the system reference tariff.

WIRP train services and establish our proposed costs and volumes associated with WIRP train services.

4.2 Estimating WIRP capital expenditure

4.2.1 Aurizon Network proposal

Proposed capital indicator

Aurizon Network's December 2014 WIRP pricing proposal provided an updated capital indicator for WIRP capital costs of \$945.3 million, inclusive of interest during construction (IDC). This is \$4.4 million lower than Aurizon Network's December 2013 estimate of \$949.7 million, which we included in the capital indicator for the purpose of developing our draft decision on the MAR.⁵⁷ Aurizon Network said the amounts presented in its updated capital indicator for WIRP adopt the post-tax nominal vanilla WACC when calculating IDC, consistent with our Draft Decision on the MAR.⁵⁸

Allocation of capital expenditure between WIRP users

In both of its WIRP pricing proposals, Aurizon Network said it allocated capital expenditure for shared WIRP project segments across the users of the segment based on their share of contracted gross tonne kilometre (gtk) attributable to the particular project segment.

The key difference between Aurizon Network's 2014 DAU and December 2014 proposals relates to the allocation of North Coast Line (NCL) project costs. In its 2014 DAU proposal, Aurizon Network allocated this expenditure only to WIRP customers located in the Blackwater system. However, in its December 2014 proposal it allocated this expenditure to all WIRP customers.

Allocation of capital expenditure to non-WIRP users

Aurizon Network said, with the exception of the Wiggins Island balloon loop and the Moura West upgrades, capital expenditure for WIRP relates to mainline upgrades that will be utilised by both new and existing customers.⁵⁹

Aurizon Network said all customers (both WIRP and non-WIRP) will receive operational benefits from WIRP, including⁶⁰:

- additional train paths, leading to greater planning flexibility, fewer contested paths and greater ability to recover from day of operation losses and maintenance activities
- added optionality and reduced system closures, as maintenance will be able to occur while still allowing trains to be scheduled on the duplicate section
- reduced speed restrictions and track failures as a result of rail replacement, renewals and strengthening.

As a result, Aurizon Network said the full capital cost of the Blackwater duplications should not be treated as costs that are incremental to WIRP train services.⁶¹

⁵⁷ QCA, 2014(h): 166; Aurizon Network also included revised capital indicator estimates for non-WIRP infrastructure in the financial model that it provided us as part of its December 2014 WIRP pricing proposal.

⁵⁸ Aurizon Network, 2014(g): 17

⁵⁹ Aurizon Network, 2014(g): 8

⁶⁰ Aurizon Network, 2014(g): 10

⁶¹ Aurizon Network, 2014(g): 8

In its 2014 DAU proposal, Aurizon Network allocated one-seventh of the total capital cost of Blackwater duplications to existing customers for the purposes of assessing the impact of socialisation.⁶² By contrast, in its December 2014 WIRP pricing proposal under the 2010 AU, Aurizon Network proposed to allocate 50 per cent of the total capital cost of Blackwater duplications to existing Blackwater system customers.

Aurizon Network said the 50 per cent allocation was appropriate for the following reasons:

- The Blackwater duplications provide operational benefits to both WIRP and non-WIRP customers.
- WIRP volumes at full utilisation would only comprise one-third of the total tonnes that use the Blackwater duplications.
- The Blackwater duplications were previously endorsed by non-WIRP customers as part of the 2008 CRIMP process in the absence of committed WIRP capacity.⁶³

Although Aurizon Network's December 2014 proposal did not allocate the WIRP capital costs to existing customers for other WIRP project segments, Aurizon Network said the existence of WIRP access conditions does not limit the sharing of infrastructure costs between WIRP and non-WIRP users.⁶⁴

Aurizon Network has not proposed to allocate any costs associated with WIRP Moura to non-WIRP customers in the Moura system.

4.2.2 Stakeholders' comments

The focus of stakeholder comments was whether the cost of Blackwater duplications should be shared with existing Blackwater customers. There were contrasting views across stakeholders on this point.

WIRP customers agreed with Aurizon Network that existing users would benefit from WIRP, through increased reliability and therefore robustness in the relevant coal systems and greater flexibility in the maintenance operations of the relevant coal systems.⁶⁵

However, WIRP customers considered Aurizon Network's proposed allocation of capital costs understated the operational benefits for non-WIRP users. They said the cost sharing with both existing Blackwater and Moura users should also take into account additional operational benefits attributable to the WIRP infrastructure including:

- rectification of long-term maintenance-intensive sections of track in the Moura system
- enhancements on the NCL that will allow improvement in the staging and sequencing of train services.⁶⁶

In contrast, all non-WIRP users were concerned about Aurizon Network's approach, saying its capacity modelling was not reliable and did not provide clear evidence of benefits to existing users. In particular:

⁶² Aurizon Network, 2014 DAU, sub. no. 6: 3

⁶³ Aurizon Network, 2014(g): 20

⁶⁴ Aurizon Network, 2014(g): 15

⁶⁵ WIRP Users, 2014 DAU, sub no. 68: 1

⁶⁶ WIRP Users, 2014 DAU, sub. no. 68: 5

- Anglo American was opposed to Aurizon Network's proposed 50 per cent cost allocation given there was no clear evidence to support this or show the duplications were required for existing users.⁶⁷
- BMA said while operational benefits will be achieved, the majority of the capital was spent to support WICET throughput.⁶⁸
- Rio Tinto raised concerns about the inconsistent representations regarding who the duplications were required for, and about Aurizon Network using different cost allocations over different WIRP pricing proposals.⁶⁹
- Asciano said Aurizon Network has confused the process. Asciano said it is unclear whether the Blackwater duplications are for existing users (despite the fact there have been no non-WICET port expansions) and so should not be included in WIRP costs, or whether they are for WIRP users and so should not be included in the cost base for the Blackwater system.⁷⁰

Further, Idemitsu and Anglo American questioned whether the system was more capable of meeting contracted tonnages after completion of WIRP. If not, they said that existing users cannot be said to have benefited.⁷¹

Asciano said a proper operational assessment should be done demonstrating the benefits accruing to non-WIRP users.⁷² For instance, while Blackwater duplications are proposed to increase the number of available train paths, the QCA needs to know the paths required to achieve baseline capacity in order to assess the genuine incremental capacity generated above this.⁷³

4.2.3 QCA analysis and draft decision

We have assessed the appropriateness of Aurizon Network's WIRP capital expenditure proposals in its 2014 DAU proposal and, for completeness, its December 2014 pricing proposal under the 2010 AU. Our analysis is outlined further below and is split into the following sections:

- prudence and efficiency of WIRP project costs
- allocation of capital costs between WIRP users (individual WIRP train services)
- allocation of capital costs to non-WIRP users (Blackwater and Moura systems).

Prudence and efficiency of WIRP project costs

We have not sought to assess the prudence and efficiency of WIRP project costs at this time. The prudence and efficiency of WIRP capital expenditure will be considered on an ex post basis via another process following the commissioning of the WIRP infrastructure.

In terms of using forecast capital expenditure to determine a tariff, Aurizon Network's approach is consistent with approaches applied to other reference tariff approval processes in the past (e.g. the GAPE system reference tariff). Once capital expenditure is approved, Aurizon Network

⁶⁷ Anglo American, 2014 DAU, sub. no. 72: 3–4

⁶⁸ BMA, 2014 DAU, sub. no. 67: 2

⁶⁹ RTCA, 2014 DAU, sub. no. 73: 1

⁷⁰ Asciano, 2014 DAU, sub no 69: 10

⁷¹ Idemitsu, 2014 DAU, sub. no. 71: 2, Anglo American, 2014 DAU, sub. no. 72: 5

⁷² Asciano, 2014 DAU, sub no. 69: 9

⁷³ Asciano, 2014 DAU, sub no. 69: 12

can apply to have future tariffs (and revenues) adjusted for any over- or underspending relative to forecast. Accordingly, we accept that it is appropriate to use an estimated capital expenditure amount for WIRP when calculating the reference tariff.

In a letter to Aurizon Network in November 2014, we requested updated capital expenditure estimates for WIRP as part of a comprehensive tariff proposal for WIRP train services.

For the purposes of this draft decision, we have:

- accepted Aurizon Network's updated capital expenditure forecasts for WIRP related projects
- retained the 2014 DAU capital indicator estimates for non-WIRP infrastructure that we used in the calculation of reference tariffs in our January 2015 Draft Decision.

Draft decision

4.1 Our draft decision is to refuse to approve Aurizon Network's proposed capital indicator for WIRP in the 2014 DAU. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Adjust the capital indicator for WIRP to be consistent with Aurizon Network's December 2014 WIRP pricing proposal.**

Allocation of capital expenditure between WIRP users

We note that Aurizon Network's December 2014 WIRP pricing proposal contains one key change to the capital allocations applied to the NCL upgrade segment as compared with its 2014 DAU approach. Under the 2014 DAU approach, we understand that capital expenditure for the NCL upgrade segment was allocated solely to WIRP customers located in the Blackwater system. In the December 2014 WIRP pricing proposal, capital expenditure for the NCL upgrade was allocated to WIRP Moura and WIRP NCL customer groups in addition to the WIRP customer groups located in the Blackwater system.

We have accepted the 2014 DAU approach to allocating North Coast Line upgrade capital expenditure. We understand this is consistent with the commercial arrangements between Aurizon Network and WIRP users. We consider these arrangements reflect agreement between Aurizon Network and each WIRP customer on the incremental capital cost attributable to the particular customer.

Draft decision

4.2 Our draft decision is to approve Aurizon Network's proposed capital cost allocation approach for WIRP customers as set out in the 2014 DAU. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above.

Allocation of capital expenditure to non-WIRP users

For capital expenditure associated with WIRP infrastructure, we consider that an allocation of expansion costs to existing (non-WIRP) users may be appropriate if:

- there is clear benefit to existing users based on the evidence provided, and
- existing users have stated they want the benefit and are willing to pay for it.

This is consistent with the notion that users pay a price reflective of the service they receive. We consider this promotes efficient infrastructure investment (ss. 69E and 138(2)(a) of the QCA Act) and appropriately takes into account the interests of existing and expanding users (ss. 138(2)(e) and (h) of the QCA Act).

While Aurizon Network and WIRP customers said that existing Blackwater and Moura system users derive a benefit from the WIRP infrastructure, we are of the view that neither has provided sufficient evidence to justify this claim or quantify the extent of any such benefits to existing users.

Blackwater

In the Blackwater system, it is evident that there is no clear consensus among stakeholders as to whether the WIRP infrastructure provides a benefit to non-WIRP users.

We consider there are three options for allocating a share to non-WIRP customers as shown in the table below

Table 3 Possible allocations of Blackwater duplication costs to existing users

<i>Share of Blackwater duplication costs</i>	<i>Basis</i>	<i>QCA Analysis</i>
0 per cent share to non-WIRP	This is the default option, in the case where there has not been evidence provided of clear benefits to existing users, that existing users wanted those benefits and were willing to pay a share of the Blackwater duplication cost to attain them.	This option is consistent with our conclusion that neither Aurizon Network nor WIRP customers provided sufficient evidence that existing customers wanted the relevant benefits or agreed to meet a share of the Blackwater duplication cost.
One-seventh share to non-WIRP	Proposed by Aurizon Network in its August 2014 guidance note on 2014 DAU treatment of WIRP.	No evidence provided by Aurizon Network or WIRP customers to quantify this level of benefits to existing users. There is not sufficient evidence that existing customers agreed to meet a one-seventh share of the Blackwater duplication cost.
50 per cent share to non-WIRP	Proposed by Aurizon Network in its December 2014 submission.	No evidence provided by Aurizon Network or WIRP customers to quantify this level of benefits to existing users. There is not sufficient evidence that existing customers agreed to meet a 50 per cent share of the Blackwater duplication cost.

Evidence

To our knowledge, neither Aurizon Network nor WIRP customers have attempted to estimate the monetary value of the operational benefits to non-WIRP customers (e.g. increased reliability or savings from maintenance over time). Further, Aurizon Network has not provided any transparency on its capacity modelling and assessments in order to verify and assist stakeholders in understanding capacity requirements pre- and post-WIRP.

As discussed in Chapter 3, we do not consider the customer endorsement of Blackwater duplications as part of the 2008 CRIMP provides any guidance on the appropriate allocation of WIRP capital costs given changes in the scope and circumstances that followed the initial customer endorsement.

Capacity modelling

Prior to the time of the investment decision, we understand that Aurizon Network's capacity modelling showed that Blackwater duplications were only required in the presence of WIRP train services. In late 2010, Aurizon Network indicated to the GCEE that, as a result of updated capacity modelling, none of the Blackwater duplications would be required for existing Blackwater system capacity.⁷⁴

Overall assessment

Our assessment is that on the basis of information available, we consider that all WIRP Blackwater capital costs should be allocated to WIRP train services.

We do, however, consider that a portion of the Wiggins Island balloon loop costs should be allocated to existing Blackwater train services, reflecting the expected use of this infrastructure by existing Blackwater train services as reflected in WIRP commercial arrangements.

Moura

With respect to Moura system upgrades, we have not been presented with any proposed allocation of WIRP costs to existing Moura users.

As a result, we accept Aurizon Network's proposal that no WIRP capital costs should be allocated to existing Moura customers.

Conclusion

Our draft decision is to refuse to approve Aurizon Network's 2014 DAU proposal to allocate one-seventh of the Blackwater duplication costs non-WIRP users. We also do not accept its December 2014 WIRP pricing proposal, to allocate 50 per cent of the Blackwater duplication costs to non-WIRP users. The reasons for refusal are:

- insufficient evidence has been provided to support or justify the specific capital cost allocations proposed by Aurizon Network
- we understand that, prior to the time of the investment decision, capacity modelling showed that Blackwater duplications were only required in the presence of WIRP train services.

Taken together, we do not consider Aurizon Network's proposed cost allocation approach is appropriate having regard to interests of relevant access seekers and access holders (ss. 138(2)(e) and (h)) of the QCA Act.

⁷⁴ Letter from Queensland Treasurer to GCEE, November 2010; Letter from Aurizon Network to GCEE, May 2010.

Draft decision

4.3 Our draft decision is to refuse to approve Aurizon Network's proposed capital cost allocation to non-WIRP users. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Adjust the capital allocation for the WICET balloon loop to reflect that existing Blackwater train paths are expected to use this project segment.**
- (b) Remove the capital allocation of Blackwater duplication costs to existing Blackwater system customers, for the purposes of defining incremental capital costs associated with WIRP infrastructure.**

4.3 Operating and maintenance costs

4.3.1 Aurizon Network proposal

In its August 2014 guidance note on its 2014 DAU pricing treatment of WIRP, Aurizon Network proposed that the maintenance and operating cost allocations to WIRP are calculated by expressing WIRP gk as a percentage of total gk (WIRP and non-WIRP) in the relevant system.⁷⁵

However in its December 2014 WIRP pricing proposal, Aurizon Network proposed zero incremental operating costs for WIRP train services. Aurizon Network said:

- it expects to make a number of productivity improvements over the 2014 DAU period and it has not costed any additional train control resources for WIRP train services
- given the WIRP related infrastructure is integrated with the existing Blackwater and Moura coal systems, it expects that the additional WIRP train services can be accommodated within its existing operating cost budget.⁷⁶

In addition, Aurizon Network also significantly reduced its proposed maintenance costs for WIRP train services in its December 2014 WIRP pricing proposal, as compared with its 2014 DAU proposal. Aurizon Network said it now expects minimal maintenance work will be required for new infrastructure constructed as part of the WIRP program, and the incremental maintenance task will be limited to scheduled preventative works in the absence of a major weather or other event. Aurizon Network also said that the renewals and replacement of existing assets in the Blackwater and Moura systems included in the WIRP program should result in a reduction in future maintenance costs.⁷⁷

Table 4 compares the operating and maintenance costs allocated to WIRP train services in each of Aurizon Network's WIRP pricing proposals.

⁷⁵ Aurizon Network, 2014 DAU, sub. no. 6: 4

⁷⁶ Aurizon Network, 2014(g): 22

⁷⁷ Aurizon Network, 2014(g): 21–22

Table 4 Allocation of operating and maintenance costs to WIRP (\$ million, nominal)

<i>WIRP costs</i>	<i>2015–16</i>	<i>2016–17</i>
<i>WIRP operating costs</i>		
Aurizon Network – December 2013	13.6	15.3
QCA Draft Decision – November 2014 ¹	9.4	10.6
Aurizon Network – December 2014	–	–
<i>WIRP maintenance costs</i>		
Aurizon Network – December 2013	31.7	34.8
QCA Draft Decision – November 2014 ¹	18.6	21.1
Aurizon Network – December 2014	1.8	2.6

Source: Aurizon Network December 2013 Financial Model; Aurizon Network 2014(g); QCA analysis. Note: (1) Consistent with our revised 2014 DAU Draft Decision MAR in our November 2014 Information Update.

4.3.2 Stakeholders' comments

Stakeholders did not comment on Aurizon Network's proposed incremental operating and maintenance costs in response to either the August 2014 guidance note or the December 2014 WIRP pricing proposal.

4.3.3 QCA analysis and draft decision

We have assessed the appropriateness of Aurizon Network's proposed operating and maintenance costs in its 2014 DAU proposal and its December 2014 WIRP pricing proposal in the context of the factors set out in section 138(2) of the QCA Act.

We consider that the operating and maintenance costs assigned to WIRP train services should, as closely as possible, align with the concept of incremental costs defined in the undertaking. That is, we consider these costs should reflect those costs that would not be incurred in the absence of WIRP train services. We are of the view that this meets the requirements of the pricing principles in section 168A of the QCA Act.

We do not consider that Aurizon Network's 2014 DAU proposal to allocate operating and maintenance costs between new and existing customers on a gtk basis is consistent with the concept of incremental costs. We have further assessed the appropriateness of Aurizon Network's proposed costs in its December 2014 WIRP pricing proposal.

Our analysis is outlined further below and is split into the following sections:

- incremental operating costs
- incremental maintenance costs.

Incremental operating costs

We agree with Aurizon Network's proposition in its December 2014 proposal that incremental operating costs for WIRP train services should be immaterial. As a result, we accept Aurizon Network's December 2014 proposal which presented zero incremental operating costs for WIRP train services.

We consider that this position is appropriate, having regard to the factors set out in section 138(2) of the QCA Act, including in particular the interests of access seekers, access holders and the legitimate business interests of Aurizon Network.

Incremental maintenance costs

We propose to accept the incremental maintenance costs proposed by Aurizon Network in its December 2014 WIRP pricing proposal.

Aurizon Network said it expects that the new infrastructure constructed as part of the WIRP programme will initially require a low level of maintenance work. Aurizon Network said that this view is consistent with those expressed by us and industry stakeholders as part of our consideration of the GAPE DAAU.

We accept that an existing mainline and a duplication of part of that mainline may have differing maintenance requirements. Newer infrastructure could require a lower level of maintenance work simply because it is newer. This would indicate a lower incremental cost, particularly in the short to medium term.

We have also assessed Aurizon Network's approach to forming its incremental maintenance estimates and consider that the estimates are derived on a consistent basis to the direct maintenance costs we assessed in our MAR draft decision.⁷⁸

Accordingly, our draft decision is to accept Aurizon Network's December 2014 proposed WIRP maintenance costs for 2015–16 and 2016–17. We consider this position is appropriate, having regard to the factors set out in section 138(2) of the QCA Act, including in particular the interests of access seekers, access holders and the legitimate business interests of Aurizon Network.

Draft decision

4.4 Our draft decision is to refuse to approve Aurizon Network's proposed allocation of operating and maintenance costs to WIRP train services in the 2014 DAU. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Use Aurizon Network's December 2014 proposed WIRP operating and maintenance costs for 2015–16 and 2016–17.**

4.4 Volumes for WIRP train services

In our view a key consideration when assessing if an expansion should be socialised within an existing system is the pricing impacts on existing users, which are largely dependent on unit WIRP costs. Volume forecasts are required to derive the unit costs associated with WIRP train services. Volume forecasts also have implications for reference tariffs, take-or-pay obligations and any revenue cap adjustments.

4.4.1 Aurizon Network's proposal

In its 2014 DAU proposal, Aurizon Network proposed that volume forecasts for WIRP train services be set at 90 per cent of contracted tonnages through WICET in the relevant year. We

⁷⁸ For the avoidance of doubt, this statement simply notes the consistency and should not be interpreted as us endorsing the approach adopted by Aurizon Network. The approach to developing maintenance costs will be considered further as part of our Final Decision on Aurizon Network's 2014 DAU.

rejected these volume forecasts in our MAR draft decision, instead proposing to adopt the CQC volume forecasts provided by our consultant, Energy Economics.⁷⁹

In its December 2014 WIRP pricing proposal, Aurizon Network expressed the following concerns about our MAR draft decision volume forecasts for WIRP train services:

- Our proposed volume forecasts did not adequately reflect the impact of take-or-pay obligations.
- Energy Economics did not engage with WIRP customers directly in setting its volume forecasts.
- A level of forecast error is contained in our forecasts given the significant discrepancy between actual CQC railings in 2013–14 and the corresponding Energy Economics forecasts released in April 2013.⁸⁰

As a result, Aurizon Network proposed revised forecasts for WIRP train services, based on the findings of an independent production review undertaken by John T Boyd Company (JT Boyd). JT Boyd's report was prepared for WICET's financiers to assess each mine's ability to satisfy their allocated WICET Stage 1 capacity. It focused on supply-side factors such as mine approval processes, ramp-up schedules and the availability of supporting infrastructure.⁸¹

The different volume forecasts for WIRP train services are presented in the table below. The exception is the revised volumes proposed by Aurizon Network in the December 2014 pricing proposal, which are excluded due to confidentiality restrictions.⁸²

Table 5 Volume forecasts for WIRP train services (Mt)

<i>Volume forecasts</i>	<i>2014–15</i>	<i>2015–16</i>	<i>2016–17</i>
Aurizon Network—April 2013	9.0	18.7	24.3
Energy Economics—April 2014	2.1	6.7	10.8

Source: Aurizon Network, 2013 DAU, sub. no. 3: 20; Energy Economics, 2014; Energy Economics, 2015.

4.4.2 Stakeholders' comments

Non-WIRP users were concerned about the lack of visibility of Aurizon Network's revised volume forecasts provided in its December 2014 pricing proposal. They said that existing non-WIRP users were not able to form a view on the reasonableness of volume forecasts, and were therefore unable to comment on the possibility of triggering take-or-pay obligations.⁸³

BMA said it understood that JT Boyd's volume forecasts for WIRP train services were based on mine production plans at the time of the WICET Stage 1 development. It questioned the validity of these volume forecasts, especially given the fact that the commercial circumstances of some WIRP customers have changed since the release of JT Boyd's report.⁸⁴ Asciano said it was

⁷⁹ QCA, 2014(h): 41–42

⁸⁰ Aurizon Network, 2014(g): 30–31

⁸¹ WICET, 2014 DAU, sub. no. 56

⁸² The JT Boyd report was provided to us by WICET Pty Ltd as part of its submission on our MAR draft decision. WICET Pty Ltd said the volume forecasts should be kept confidential by the QCA. A redacted version of this report is available on our website with other submissions on our MAR draft decision.

⁸³ Anglo American, 2014 DAU, sub. no. 72: 5; Asciano, 2014 DAU, sub. no. 69: 5; RTCA, 2014 DAU, sub. no. 73: 2

⁸⁴ BMA, 2014 DAU, sub. no. 67: 2

concerned with the independence of forecast volumes and suggested the QCA assess this matter.⁸⁵

In contrast, WIRP users firmly believed Aurizon Network's proposed volume forecasts were reasonable and potentially conservative, given some individual WIRP customer forecasts exceeded those in the JT Boyd report and Aurizon Network's forecasts did not account for likely demand for consuming additional 'ad-hoc' port capacity at WICET.⁸⁶

4.4.3 Consultant's assessment

We consider that our proposed draft decision volume forecasts should be updated to reflect the latest available information. Given stakeholders' concerns about the visibility and accuracy of Aurizon Network's updated forecasts, we have engaged Energy Economics to produce an assessment of volume forecasts of WIRP train services. We believe such an assessment mitigates stakeholder concerns regarding any risk of bias and ensures the volume forecasts are developed on an independent footing.

As part of our engagement with Energy Economics, we have also sought to update the volume forecasts for all train services in the Blackwater and Moura systems. We consider this wider scope is required to ensure that any comparison of the unit costs of WIRP and non-WIRP train services in the relevant systems uses volume forecasts that are up-to-date and consistent in accounting for transfers of forecast tonnages between existing Gladstone coal terminals and WICET.⁸⁷

In developing its updated estimates, Energy Economics said it considered various factors including mine and port capacity, take-or-pay rail and port contracts, production rates, coal reserves and resources, potential mining and/or market issues and mine expansion plans.

Energy Economics has sought to engage with relevant stakeholders including WIRP and non-WIRP customers to ensure that all available information is incorporated in the revised estimates.

Blackwater and Moura volume forecasts

In the table below, we have compared volume forecasts provided by Aurizon Network in December 2014 with the updated Energy Economics forecasts for the Moura and Blackwater catchment areas.

⁸⁵ Asciano, 2014 DAU, sub. no. 69: 5

⁸⁶ WIRP Users, 2014 DAU, sub. no. 68: 2

⁸⁷ This engagement is also the first stage of a broader scope to review Aurizon Network's updated volume forecasts for the whole CQCN—as provided in its December 2014 response to our MAR draft decision—for the purposes of our 2014 DAU final decision.

Table 6 Volume forecasts for Blackwater and Moura (Mt)¹

<i>Volume forecasts</i>	<i>2015–16</i>	<i>2016–17</i>
<i>Aurizon Network forecasts – December 2014</i>		
Moura	13.5	15.8
Blackwater	68.3	70.6
Total	81.8	86.4
<i>Energy Economics forecasts – July 2015</i>		
Moura	13.6	14.3
Blackwater	63.9	67.8
Total	77.5	82.1
Absolute difference (total)	–4.3	–4.3
% difference	–5.3%	–4.9%

Source: Aurizon Network December 2014 WIRP Financial Model; Energy Economics, 2015. Notes: (1) Blackwater and Moura volume forecasts include volumes associated with WIRP train services.

Energy Economics' total volume forecasts for the Blackwater and Moura systems are 159.6 million tonnes (Mt) over the two-year period. This is 5.1 per cent lower than Aurizon Network's forecast of 168.2 Mt over this period. It is also 0.3 per cent lower than Energy Economics' previous forecasts in April 2014.

Energy Economics said while international growth is expected to be modest over the forecast period, the weakening of the Australian dollar will allow large low-cost domestic producers to maintain or increase their share of the international market.⁸⁸ While demand from China is expected to remain weak in the short term, this is expected to be counterbalanced by increasing demand from India, South-East Asia and Europe.

Energy Economics said that Aurizon Network has not published its forecasting methodology, with the exception of WIRP train services.⁸⁹

WIRP train services

In its updated forecasts, Energy Economics estimated that a total of 30.7 Mt of coal will rail to WICET (WIRP train services) over the period from 2015-16 to 2016-17. Energy Economics said this higher forecast compared to its April 2014 forecast was partly driven by the increased production expectations for the Rolleston and Cook mines.⁹⁰

Table 7 Energy Economics July 2015 volume forecasts—WIRP train services (Mt)

<i>Volume forecasts</i>	<i>2015–16</i>	<i>2016–17</i>
Energy Economics—April 2014	6.7	10.8
Energy Economics—July 2015	12.1	18.6
Difference	5.4	7.8

Source: Energy Economics, 2015.

⁸⁸ Energy Economics, 2015: 17–23

⁸⁹ Energy Economics, 2015: 26

⁹⁰ Energy Economics, 2015: 6

A key point raised by Energy Economics is the incentive for WIRP customers to prioritise fulfilment of WICET obligations over railings to other destinations. Energy Economics' forecasts for WIRP train services have included redirection of some tonnage from other destinations to WICET.⁹¹ This is driven by what appears to be more stringent take-or-pay conditions on WICET throughput allocations relative to other destinations, meaning that WIRP users that have access to other destinations in addition to WICET are expected to give precedence to fulfilling WICET take-or-pay volumes.

4.4.4 QCA analysis and draft decision

We consider incremental volumes associated with WIRP train services should reflect additional coal railings that would not have occurred in the absence of WIRP contracted capacity. This is consistent with our view on incremental costs which relate to additional costs incurred by Aurizon Network (or to the extent funded under a Standard User Funding Agreement) in fulfilling these train service entitlements.

However, in measuring the volumes associated with WIRP infrastructure, a key issue emerging from Energy Economics' assessment is the substitutability of train services and the implications this has for defining incremental volumes. In the section below we discuss alternative approaches to estimating a reasonable volume associated with WIRP to address this issue.

Our draft decision is to adopt Energy Economics' forecast of expected railings of WIRP train services, capped to below-rail contract entitlements, as a proxy of WIRP incremental volumes. In our view this is the most appropriate approach to setting volumes associated with WIRP train services for pricing purposes currently available for this assessment.

Substitutability of train services

The estimation of incremental volumes is relatively straightforward for WIRP train services associated with new mines that only have train service entitlements to WICET. Any forecast coal railings associated with these new mines would be treated as incremental volume for pricing purposes.

However, the situation is more complicated for existing brown-field mines that have been operating prior to WIRP. These mines have both WIRP (i.e. to WICET) and non-WIRP (i.e. to other Port of Gladstone terminals) train service entitlements, which are largely substitutable. The incremental volume associated with WIRP train services is not easily observable in this case.

This issue of substitutable train services is illustrated in Energy Economics' volume forecasts, with WIRP volume forecasts comprised of both 'incremental' and 'existing' (transferred from another destination) tonnages.

In effect, we are currently of the view that it is not possible to derive a true incremental volume when there are substitutable train services of this type. We therefore need to consider whether it is possible to derive proxy incremental volumes to enable us to estimate a reasonable volume associated with WIRP.

Approaches to estimating proxy incremental volumes

We have identified two alternative approaches to estimating proxy incremental volumes for mines with WIRP and non-WIRP train service entitlements where substitutability is an issue:

- Adopt the best estimate of these mines' expected railings of WIRP train services.

⁹¹ Energy Economics, 2015: 6

- Develop an apportionment mechanism.⁹²

We have assessed the advantages and disadvantages of these options in the table below.

Table 8 Options for proxy incremental volumes

<i>Option</i>	<i>Advantages</i>	<i>Disadvantages</i>
Expected railings of WIRP and non-WIRP train services	<ul style="list-style-type: none"> • Volumes will more accurately reflect actual railings to WICET. • An objective method that does not require arbitrary adjustments and provides certainty should volume forecasts change. 	<ul style="list-style-type: none"> • Volume splits based on expected railings could lead to a material increase in existing (non-WIRP) users' access charges. This is because they are based on the assumption that individual mine production volumes will be prioritised to WIRP train services before existing (non-WIRP) train services (as WIRP and non-WIRP train services are substitutable).
Apportionment mechanism	<ul style="list-style-type: none"> • This method may be used to manage the impact on existing non-WIRP customers. • This method would be appropriate if there was general industry agreement on how the apportionment would apply to WIRP and non-WIRP railings. 	<ul style="list-style-type: none"> • This method is somewhat arbitrary and could be skewed to a desired outcome. • This option would result in derived volumes being different to expected railings for WIRP and non-WIRP train services. This could lead to adverse implications for take-or-pay obligations and/or revenue cap adjustments for non-WIRP customers if a separate reference tariff for WIRP was implemented.⁹³ • To address this, an adjustment mechanism to reduce these impacts on non-WIRP customers would be necessary, however this would increase the complexity of the pricing arrangements.

Overall we currently consider that the option of expected railings of WIRP and non-WIRP volumes is the appropriate method for deriving a proxy incremental volume.

We note that the expected railings to WICET at the individual train service level, as forecast by Energy Economics, is in some instances higher than the volumes actually contracted to WICET. This could mean that tariffs for existing users are increased to a level that is not representative of contracted volumes, which we regard as an unreasonable outcome, and one that we consider to be inappropriate, having regard to the factors set out in section 138(2) of the QCA Act.⁹⁴ We therefore propose that the proposed WIRP pricing arrangements be amended by ensuring

⁹² For example, the forecast railings allocated to WIRP train services could be based on an estimate of the net increase in the mine's total coal railings as compared with a base level reflecting its historical railings prior to the commissioning of WIRP.

⁹³ It is possible that WIRP users may over-rail to WICET and under-rail to other Port of Gladstone terminals relative to our derived volumes for pricing. If a separate reference tariff was implemented for WIRP (with separate take-or-pay and revenue cap arrangements), this could trigger system take-or-pay or lead to material under-recovery of revenue in the non-WIRP system.

⁹⁴ While WIRP users may be able to transfer additional TSEs to WICET, capping provisions in Aurizon Network's 2014 DAU (or our proposed amendments to this) would not allow the user to offset revenue from over-railings to WICET against take-or-pay liabilities associated with under-railings in non-WIRP train services.

substitution of tonnages to WICET does not exceed the volumes actually contracted to WICET, for the purposes of determining tariffs.

On the basis of the information available, we have adopted this approach for our draft decision. We consider this method is appropriate, having regard to the factors set out in section 138(2) of the QCA Act, including in particular, the interests of access seekers and access holders.

Draft decision

4.5 Our draft decision is that, based on the information before us, the appropriate approach to deriving proxy incremental volumes is to:

- (a) Use expected railings of WIRP and non-WIRP volumes option rather than a apportionment mechanism**
- (b) Cap WIRP volumes to contracted volumes.**

However, we would consider an apportionment approach for determining incremental volumes in the final decision if the basis for such an approach was supported by all industry stakeholders.

Proposed WIRP volume forecasts

When applying our preferred methodological approach, our draft decision is to adopt Energy Economics' volume forecasts at both the aggregate and individual mine levels. We have also made the draft decision to adjust Energy Economics' volume forecasts at the individual train service level (i.e. the mine to port level) to cap volumes for WIRP train services at the contracted volume ramp-up in below-rail access agreements. Our reasoning for these decisions is:

- we consider Energy Economics' forecasts to be the best available as they are based on more up-to-date information and a bottom-up approach to developing forecasts at an individual mine level. In addition, we consider Energy Economics' forecasts are more transparent, with visibility of WIRP forecasts and the underlying justification for all affected stakeholders.
- at the individual train service level (i.e. at the mine–port level), we have compared Energy Economics' forecasts with the contracted volume ramp-up negotiated between Aurizon Network and each individual WIRP user reflected in WIRP access agreements. We consider that prices for WIRP train services should reflect the use of train service entitlements in WIRP access agreements, and consider that this negotiated ramp-up reflects a cap to the shifting of tonnages to WICET.

Accordingly, we have adjusted Energy Economics' forecasts for WIRP train services as summarised in the table below.⁹⁵

Table 9 QCA proposed volume forecasts—WIRP train services (Mt)

<i>Volume forecasts</i>	<i>2015–16</i>	<i>2016–17</i>
Energy Economics—July 2015	12.1	18.6
QCA adjustments	(1.1)	(2.1)
QCA proposed volume forecasts	11.0	16.5

Source: *Energy Economics, 2015; QCA Analysis*

⁹⁵ This adjustment to WIRP volumes will be exactly offset by a corresponding adjustment to non-WIRP train services, maintaining the Energy Economics' volume forecasts at the individual mine and aggregate levels.

We consider the use of independent volume forecasts for pricing purposes is appropriate in balancing the interests of access seekers and access holders under section 138(2) of the QCA Act. We also consider that it is consistent with section 137(1A) (cost allocation) and section 168A (pricing principles).

Draft decision

4.6 Our draft decision is to refuse to approve Aurizon Network's proposed volume forecasts. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Adopt the forecast volumes for WIRP and non-WIRP train services consistent with Energy Economics' forecasts and the adjustments to cap WIRP volumes to contracted volumes.**

5 ASSESSMENT OF WIRP PRICING OPTIONS

In this chapter we assess various options for pricing WIRP train services in order to enable us to determine the appropriateness of the reference tariffs for WIRP proposed under the 2014 DAU. We consider Aurizon Network's assessments too narrow to be an appropriate basis upon which to make an informed decision on WIRP pricing arrangements.

We have identified three options for WIRP pricing to assist in our analysis:

- *socialised pricing approach—all WIRP and non-WIRP train services pay the same system reference tariff (with combined take-or-pay arrangements and revenue cap)*
- *system premium approach – a system reference tariff is set but, in addition to this, WIRP users pay a premium to reflect their higher incremental costs (combined take-or-pay arrangements and revenue cap still apply as per the socialised pricing approach described above)*
- *separate reference tariff – allocating WIRP costs and volumes to a new coal system⁹⁶ or separate expansion tariff for pricing purposes (with separate take-or-pay arrangements and revenue cap).*

Based on an assessment of these options, we conclude the pure socialised pricing approach is not appropriate. We also found that a separate reference tariff applied in the Blackwater system would be inappropriate since the substitutability of volumes may have the effect of shifting volume risk to existing customers.

On this basis, we consider the adoption of the system premium approach to be an appropriate amendment to the proposed WIRP pricing arrangements.

5.1 Introduction

In our view, Aurizon Network's assessments of pricing set out in the proposed WIRP pricing arrangements were too narrow to provide a sufficient basis for us to make an informed decision on WIRP pricing arrangements, particularly for the Blackwater and Moura systems. Consequently, we consider it necessary to review a range of potential approaches to pricing WIRP train services.

We have identified three options:

- *socialised pricing approach – all WIRP and non-WIRP train services pay the same system reference tariff (with combined take-or-pay arrangements and revenue cap)*
- *system premium approach – a system reference tariff is set, but in addition, WIRP users pay a premium to reflect their higher incremental costs (combined take-or-pay arrangements and revenue cap still apply as per the socialised pricing approach described above)*
- *separate reference tariff – allocating WIRP costs and volumes to a new coal system⁹⁷ or separate expansion tariff for pricing purposes (with separate take-or-pay arrangements and revenue cap).*

⁹⁶ Consistent with the pricing approach for the Goonyella to Abbot Point (GAP) system.

⁹⁷ Consistent with the pricing approach for the GAP system.

For the NCL train service⁹⁸, we assess whether it is appropriate to apply similar pricing arrangements to those we approved for the Colton to Barney Point train service in April 2012 (see Chapter 6).⁹⁹

To evaluate these pricing options, we have set out an assessment approach, applying criteria that take into account the statutory requirements under the QCA Act. On the basis of our cost and volume draft decisions outlined in Chapter 4, our conclusion is:

- the pure socialised pricing approach is not appropriate as the socialised price is higher than the average existing price and is therefore not consistent with the section 168A pricing principles, particularly section 168A(b) which relates to cost reflectivity and efficiency
- if a separate reference tariff is applied to WIRP customers in the Blackwater system, the substitutability of volumes may have the unintended effect of shifting volume risk associated with WIRP to existing customers. For example, if WIRP customer volumes are lower than expected, and port take-or-pay provisions lead to the prioritisation of WICET over other destinations, take-or-pay obligations for non-WIRP customers may increase. This is not an appropriate allocation of risk and is counter to the pricing principles, the interests of access holders and the public interest
- on this basis, and having considered that it was not appropriate to approve Aurizon Network's proposed WIRP pricing approach having had regard to the factors set out in section 138(2) of the QCA Act, we consider it appropriate to amend the proposed approach by adopting a system premium approach. In making this draft decision, we have taken into account of factors specific to WIRP (discussed in Section 5.5 and Chapter 6).

We reiterate that this analysis relies on our cost and volume assumptions. Outcomes may be different if an agreed apportionment method can be derived to better define incremental volumes (see Chapter 4). This is a matter for the industry to consider.

5.2 Stakeholders' comments

Similar to Aurizon Network, WIRP users are of the view WIRP should be socialised. The WIRP users group said it understood from Aurizon Network the WIRP extensions would be socialised since this was consistent with the WIRP customers accepting Aurizon Network's desire to electrify all duplications, despite WIRP customers planning diesel hauled operations.¹⁰⁰

Non-WIRP users of the Moura and Blackwater systems, such as BMA, Idemitsu and RTCA, opposed this view. BMA said existing non-WIRP users should not bear any additional costs if:

- there is no clear and significant financial or operational benefit in the form of increased system throughput at efficient costs
- non-WIRP users were not involved in the negotiations of the expansion project.¹⁰¹

Idemitsu said they would be less concerned if genuine take-or-pay arrangements applied for new expanding users, irrespective of overall system volumes.¹⁰²

⁹⁸ This refers to the Colton to WICET train service.

⁹⁹ QCA, 2012(e).

¹⁰⁰ WIRP users, 2014 DAU, sub. no. 68: 6; New Hope, 2014 DAU, sub. no. 66: 2

¹⁰¹ BMA, 2014 DAU, sub. no. 67: 1

¹⁰² Idemitsu, 2014 DAU, sub. no. 71: 2

RTCA supports the principle that where network expansions are required to meet the demand of new and or expanding users, then existing users of the network should be no worse off from a pricing and/or take-or-pay exposure perspective.¹⁰³

5.3 QCA assessment approach

5.3.1 Assessment criteria

We have developed a set of assessment criteria for evaluating alternative pricing and cost allocation options (see table below). We are of the view these are consistent with achieving an appropriate balance of the section 138(2)(b) matters which we are required to have regard to under the QCA Act.

Table 10 QCA approach to assessing WIRP pricing arrangements

<i>Assessment criterion</i>	<i>Rationale</i>
Do the pricing arrangements allow Aurizon Network to recover its efficient costs?	<p>The WIRP pricing arrangements should allow Aurizon Network to recover at least its efficient costs, as provided for in section 138(2)(b) and 168(A)(a) of the QCA Act.¹⁰⁴</p> <p>Where pricing and tariff arrangements allow Aurizon Network to recover no more than its efficient costs, including a return on investment commensurate with the risks involved (in accordance with section 168A(a)), this also meets the object of Part 5 of the QCA Act, provides an incentive to reduce costs or otherwise improve productivity (section 168A(d)), is in line with the public interest and the legitimate business interests of Aurizon Network, as well as being in the interests of access seekers and access holders.</p>
Are the pricing and tariff arrangements cost reflective?	<p>The WIRP pricing arrangements should support cost reflective pricing.</p> <p>If the price for access is not cost reflective pricing signals can lead to undesirable responses. For instance, access seekers and holders may have the incentive to over contract (if they are not paying the full cost of access to that part of the network) or may pay more than their efficient costs. This is not consistent with the object of Part 5 of the QCA Act, the public interest or the interests of access seekers and access holders.</p>
Do the pricing arrangements reflect an appropriate allocation of risk between access holders, access seekers and Aurizon Network?	<p>An appropriate allocation of risk between WIRP customers, non-WIRP customers and Aurizon Network is an important consideration in developing the pricing arrangements to apply to WIRP and non-WIRP customers.</p> <p>Risk allocation should consider the implications of any existing risk allocation arrangements and the extent to which access holders who do not require the expansion should bear any risk associated with the expansion.</p>
Do the pricing and cost allocation arrangements promote transparency, certainty and minimise complexity?	<p>The pricing and cost allocation arrangements should be transparent, certain and limit complexity, to the extent practicable. This promotes confidence in the regulatory arrangements.</p>

¹⁰³ RTCA, 2014 DAU, sub. no. 73: 2

¹⁰⁴ We have not sought to assess the prudence and efficiency of WIRP project costs at this time. The regulatory approach assesses the prudence and efficiency of capital expenditure on an ex-post basis. We will make a separate decision on this matter via another process following the commissioning of the WIRP infrastructure.

5.3.2 Previous considerations of expansion pricing

As discussed in Chapter 3, we previously considered the pricing treatment of a major expansion in the context of GAPE train services. At that time, we approved Aurizon Network's proposal to establish a separate GAPE system and tariff. The approach adopted for GAPE was consistent with our view at that time on how best to price capital expansions in rail and ports. Our discussion paper, *Capacity Expansion and Access Pricing for Rail and Ports*, reflected that view and introduced the proposition of 'averaging down/incremental up'—which later played a role in the expansion pricing framework under Aurizon Network's 2014 DAU.¹⁰⁵

In addition, when we were assessing Aurizon Network's proposed expansion pricing framework for our draft decision on its 2014 DAU, we established that certain principles should form the basis of the expansion pricing framework. The principles are:

- The user(s) requiring the expansion should generally pay an access charge that reflects at least the full incremental costs (capital and operating) of access.
- Existing users should not experience a material increase in tariffs due to an expansion triggered by access seekers.
- If new/expanding users face a higher cost than existing users, a zero CCC from expanding users is generally acceptable.
- An allocation of expansion costs to existing users may be appropriate where an expansion has clear benefits to those users.

Our draft decision also proposed no future expansions be socialised within an existing system until we could apply a more stringent take-or-pay regime (which we termed as the 'fixed-cost' regime) to all train services. We considered under the current take-or-pay regime, existing users might still bear part of the costs of the expansion, even if the expansion initially led to lower tariffs for those users.

The outcome of this approach was expanding users would be subject to a separate expansion tariff, with separate take-or-pay and revenue cap. We also proposed to apply a 'fixed-cost' regime to expanding users so that each expanding user's volume risk would be largely confined to its own contracted volume, and not to those of other expanding users. In response to our draft decision, Aurizon Network and stakeholders supported the four expansion pricing principles but were concerned by our proposed expansion pricing framework.

However, it has become apparent that the ability to isolate an expansion¹⁰⁶ is complicated when train services are substitutable (see Chapter 4 for further detail). As a result, the decision about whether to socialise an expansion into an existing system becomes less clear-cut, and we have taken into account other factors when making our decision.

In certain circumstances, even if an expansion fails a simple mechanistic socialisation test, socialisation may be the best option. This issue is considered further below.

¹⁰⁵ This proposition specifies that if average costs are decreasing substantially with capacity, adding the expansion costs to the cost base of the established capacity will usually provide an acceptably efficient and fair outcome. Conversely, if average costs are increasing substantially with capacity, a separate access price should normally be calculated and charged to those whose capacity underwrites the new tranche of capacity that reflects the average cost of that new capacity.

¹⁰⁶ In the manner described in our draft decision on Aurizon Network's 2014 DAU (QCA, 2015).

5.3.3 Assessment approach

Overall, we consider that:

- requiring WIRP train services to bear at least incremental costs is consistent with cost-reflective pricing arrangements and appropriately allocating costs without unfairly differentiating in a material way between access holders and seekers
- allocating WIRP costs to non-WIRP customers where WIRP has clear benefits to those users is consistent with cost-reflective pricing arrangements and appropriate allocation of costs
- minimising the impact on existing users (non-WIRP customers) of an expansion triggered by other users (WIRP customers) is consistent with appropriate allocation of costs and risks
- imposing a CCC on WIRP customers is not necessarily required for cost-reflective pricing arrangements and appropriate allocation of risks and costs. This is because a zero CCC from WIRP customers, other things equal, does not make non-WIRP customers 'worse off'.

(Sections 137(1A)(a), 138(2)(d), (e), (g), and (h) and 168A(b) of the QCA Act).

This is consistent with the four principles previously established in our draft decision on Aurizon Network's 2014 DAU for the expansion pricing framework (as set out in Section 5.3.2). We are also of the view that it is consistent with our assessment criteria (as set out in Section 5.3.1) and the factors set out in section 138(2) of the QCA Act. Further, this does not imply we are ruling out socialisation of WIRP nor, in our view, does it mean the above requirements are not compatible with the socialisation of WIRP in some form.

This means it is necessary to firstly assess whether WIRP should be socialised using a simple mechanistic socialisation test. If that test suggests WIRP should not be socialised, we consider what the potential implications of not socialising WIRP are, whether the outcome of this should influence the decision about whether to socialise WIRP and, if so, how socialisation could be undertaken.

Against this background, the remainder of this chapter firstly assesses whether WIRP should be socialised based on adopting mechanistic socialisation tests. Thereafter it considers the implications of the result of this with respect to:

- under-utilisation of WIRP train service entitlements
- volume risks and substitutability of train services
- complexity, transparency and certainty of pricing arrangements.

Chapter 6 then sets out our proposed pricing arrangements for WIRP train services.

5.4 Assessment of socialisation impacts (for Blackwater and Moura)

In this section, we assess whether a socialised outcome (i.e. all WIRP train services pay the system reference tariff) would increase the baseline system reference tariff for existing non-WIRP train services in Blackwater and Moura. We have undertaken our assessment below over two steps:

- (1) Establish the baseline system reference tariff (on a \$/nt basis excluding costs allocated to WIRP train services) for the Blackwater and Moura systems (Section 5.4.1)

- (2) Compare the baseline system reference tariff to the same tariff (on a \$/nt basis) once the WIRP costs and volumes are socialised within the system (Section 5.4.2).¹⁰⁷

5.4.1 Establish the baseline system reference tariff

The baseline system reference tariff reflects the tariff that would apply to existing users if we completely isolated existing users from the costs and volumes associated with WIRP.¹⁰⁸

To establish the baseline system reference tariff for the Blackwater system, we firstly need to assess whether incremental Rolleston spur costs should be included in the calculation of the baseline Blackwater system reference tariff.¹⁰⁹ In our January 2015 draft decision¹¹⁰, we excluded costs associated with existing Rolleston train services in our calculation of the non-electric tariff components (i.e. AT₁ to AT₄) of the Blackwater system reference tariff.¹¹¹ This is because the existing Rolleston train service failed our application of the 2010 AU 'system entry' test.¹¹²

The Moura system does not have this complication and we have derived the baseline system reference tariff based on all costs and volumes excluding those allocated to WIRP train services.

Application of Subclause 4.1.2 to existing Rolleston spur line (Blackwater system)

As noted in Chapter 3, under Subclause 4.1.2 of Schedule F, Part B of the 2010 AU:

In order to reflect the requirements of Subclause 4.1.1, the Reference Tariff applicable for a new coal carrying Train Service will be the higher of (on a \$/ntk basis):

- (a) *the Reference Tariff for the relevant Individual Coal System Infrastructure; or*
- (b) *the sum of the new coal carrying Train Service's Private Incremental Costs (if any), the Incremental Costs of using any Rail Infrastructure specifically related to the new coal carrying Train Service and the required minimum Common Cost contribution ...*

provided that the Access Charge payable to QR (now Aurizon) Network for the operation of that new coal carrying Train Service is calculated as the applicable Reference Tariff less the Private Incremental Costs (if any).

In Aurizon Network's 2014 DAU proposal, its application of Subclause 4.1.2 resulted in a system premium being required for the Rolleston (non-WIRP) train service. However, in its December 2014 WIRP pricing proposal, no system premium was applied.

Table 11 below presents our application of Subclause 4.1.2 for existing Rolleston train services, based on updated costs and volumes consistent with our draft decisions in Chapter 4. Criterion (a) in the table is derived on a similar basis to the Blackwater system reference tariff presented in our January 2015 draft decision—that is; excluding costs associated with existing Rolleston train services (and excluding costs associated with WIRP). Criterion (b) in the table shows the

¹⁰⁷ We have applied a revenue smoothing factor for WIRP allowable revenue in our calculation of this socialised price, consistent with Aurizon Network's proposed approach.

¹⁰⁸ That is, the price that would apply to existing users if a separate reference tariff was applied to WIRP train services that recovered all of the costs and volumes associated with WIRP train services.

¹⁰⁹ This is applied to the non-electric tariff only, as the system premium that eventuates from the 'system entry' test is applied to the AT₃ which is a non-electric tariff component.

¹¹⁰ QCA, 2015.

¹¹¹ Rolleston train services were assigned a higher reference tariff that covered their spur line incremental costs and a minimum CCC. This higher reference tariff was presented in the form of a system premium in addition to the Blackwater system reference tariff.

¹¹² The 2010 AU 'system entry' test refers to the application of Subclause 4.1.2 of Schedule F of the 2010 AU.

alternative reference tariff that would apply to Rolleston if it exactly covered its incremental costs and minimum CCC.¹¹³

Table 11 Application of Subclause 4.1.2 for Rolleston non-electric tariff (\$ per ntk, nominal)

<i>Application of Subclause 4.1.2</i>	<i>2015–16</i>	<i>2016–17</i>
<i>Rolleston - Non-Electric (\$ per ntk, nominal)</i>		
Criterion (a)—reference tariff ¹	0.0132	0.0139
Criterion (b)—incremental costs + CCC	0.0169	0.0183

Notes: (1) Base system reference tariff, after an adjustment to remove the incremental costs and minimum CCC attributable to Rolleston train services. We note that in Aurizon Network's December 2014 WIRP pricing proposal, it did not deduct the minimum CCC in deriving criterion (a). However, this does not affect the outcome of this test using our proposed costs and volumes.

Table 11 shows the tariff required to cover Rolleston spur line incremental costs and minimum CCC (criterion (b)) is higher than the baseline system reference tariff (criterion (a)). This means:

- existing Rolleston train services should continue to pay a system premium in addition to the Blackwater system reference tariff to ensure they pay at least the incremental costs and minimum CCC attributable to their train service
- the baseline system reference tariff for the Blackwater system (excluding costs allocated to WIRP train services) should not include the costs and volumes associated with existing Rolleston train services.

As existing Rolleston train services did not pass the system entry test, for the purposes of the analytical exercise we have excluded the associated costs (including CCC) from the calculation of the baseline Blackwater system reference tariff used in our comparisons in Section 5.4.2.

Baseline system reference tariff for Blackwater and Moura

Our comparison in the next section is on a \$/nt basis. Table 12 below shows the baseline system reference tariffs we apply in the next section in our assessment of socialisation impacts.

Table 12 Baseline system reference tariff for Blackwater and Moura (\$/nt, nominal)

<i>Baseline system reference tariff</i>	<i>2015–16</i>	<i>2016–17</i>
<i>Blackwater system</i>		
Non-electric only (AT ₁ –AT ₄) ¹	4.91	5.15
Total non-electric and electric (AT ₁ –AT ₅) ²	6.60	6.49
<i>Moura system</i>		
Total non-electric and electric (AT ₁ –AT ₅)	3.23	3.59

Notes: (1) Base system reference tariff, after the adjustment to remove the minimum CCC attributable to Rolleston train services. This is equivalent to criterion (a) in Table 11 above, converted to a \$/nt basis. (2) Excludes Rolleston electrification costs.

¹¹³ The minimum CCC is defined in Subclause 4.1.1 of Schedule F of the 2010 AU as equal to the sum of AT₂ and 50 per cent of AT₃ for the distance the particular train service will travel on the Blackwater system mainline.

5.4.2 Compare the baseline and socialised system reference tariff

In this next step, we have applied a mechanistic socialisation test to compare the average system reference tariff, on a \$/nt basis, applicable to existing customers under:

- the baseline system reference tariff (excluding costs allocated to WIRP train services), and
- the same tariff once the WIRP costs and volumes are socialised within the system.

We have applied this test separately for Blackwater and Moura systems, over the remaining years of the 2014 DAU post WIRP commissioning (2015–16 and 2016–17). Based on our analysis below, the inclusion of the proposed WIRP costs and volumes would result in an increase in the Blackwater and Moura system reference tariffs.

Table 13 below compares the average system reference tariffs for existing non-WIRP train services¹¹⁴ with and without socialisation of WIRP costs and volumes.

Table 13 Comparison of average system reference tariff for existing train services (\$/nt, nominal)

<i>Average system reference tariff</i>	<i>2015–16</i>	<i>2016–17</i>
<i>Blackwater system</i>		
Existing system excluding WIRP ¹	6.60	6.49
Existing system including WIRP (socialised) ^{2,3}	6.79	6.75
Difference (%)	2.9%	4.1%
<i>Moura system</i>		
Existing system excluding WIRP	3.23	3.59
Existing system including WIRP (socialised) ³	3.29	3.72
Difference (%)	1.9%	3.7%

Source: QCA analysis. Notes: (1) Excluding existing (non-WIRP) Rolleston train services, for which an additional system premium would apply. (2) Excluding Rolleston WIRP and non-WIRP train services, for which an additional system premium would apply. (3) We have applied a revenue smoothing factor for WIRP allowable revenue in our calculation of this socialised price, consistent with Aurizon Network's proposed approach.

Table 13 shows that both the Blackwater and Moura system reference tariffs would increase, on average, if WIRP was socialised within these systems.

Our analysis shows that a socialised outcome would result in a material increase in the Blackwater and Moura system reference tariffs, that is, existing users would pay more. This indicates that, based on our cost and volume draft decision, the pure socialisation approach is not consistent with our assessment criteria.

5.5 Assessment of WIRP pricing options

While the preceding analysis provides a strong argument against pure socialisation for the Blackwater and Moura systems, we have undertaken further analysis to take into account:

¹¹⁴ We have undertaken this analysis from the perspective of those existing train services that pay the system reference tariff (with no system premium). For the Blackwater system, the average system reference tariff would not apply to Rolleston train services, as these would face an additional system premium under both the baseline and socialised scenarios.

- under-utilisation of WIRP train service entitlements
- volume risks and substitutability of train services
- complexity and transparency of pricing arrangements.

Under-utilisation of WIRP train service entitlements

In the context of this draft decision under-utilisation relates to the circumstances where contracted uptake for an expansion occurs over a ramp-up period resulting in spare capacity being available for a time.

An option to address under-utilisation is to align WIRP-related revenue with the ramp-up of WIRP volumes. In both of its WIRP pricing proposals, Aurizon Network proposed a form of revenue smoothing factor so that revenue is escalated at the same percentage increase as volumes, where volumes are specified according to the forecasts provided in Aurizon Network's submission.¹¹⁵ We have also applied this revenue smoothing factor to WIRP allowable revenue in our assessment and calculation of reference tariffs for WIRP train services.

We note that Aurizon Network also proposed a revenue deferral approach in 2013 in the context of the Newlands to Abbot Point expansion (NAPE) customer share of GAPE project costs.¹¹⁶ The rationale put forward by Aurizon Network in the GAPE DAAU application was that:

- customers operating during the ramp-up period would benefit as they would not be subject to the 'full cost recovery' tariff at a time when capacity would not be fully utilised
- the purpose was to ensure that existing users did not see a material impact in their access charge
- this would otherwise be the case if the NAPE customer share of GAPE capital costs were included immediately in the applicable reference tariff
- deferring this portion of GAPE project capital would better align the inclusion of capital to the tonnage ramp-up profile; presenting a clear benefit to customers.

We consider that a similar deferral approach may be justified to take into account under-utilisation in the context of WIRP pricing arrangements.

Volume risks and substitutability of WIRP train services

Under a socialised price or system premium approach, non-WIRP customers are exposed to volume risks associated with WIRP. On this basis, establishing a separate reference tariff (with separate take-or-pay arrangements and revenue cap) for WIRP train services would normally provide greater protection for non-WIRP customers from this volume risk.

However, this protection is compromised when WIRP access holders have WIRP and non-WIRP train service entitlements and these are substitutable. Further, as noted in our discussion regarding volumes in Chapter 4, we consider some WIRP customers may have incentives to prioritise WIRP train service entitlements over existing entitlements.

¹¹⁵ Aurizon Network, 2014 DAU, sub. no. 6: 5; Aurizon Network, 2014(g): 26; This approach derives a smoothed revenue profile over 2015–16 and 2016–17 with an equivalent present value as the unsmoothed revenue stream. Aurizon Network proposed this approach in both its 2014 DAU and its December 2014 WIRP pricing proposal.

¹¹⁶ In addition to this measure for NAPE train services, GAPE pricing arrangements also included the deferral of all depreciation associated with this \$1.0 billion project over the initial two years (2011–12 and 2012–13).

WIRP users that have both existing and WIRP access entitlements have the option of choosing the order and extent to which they use each of their entitlements. In addition, this choice is influenced by the matching port obligations and it is reasonable to assume a user would seek to maximise tonnage while minimising costs (both rail and port).

As previously stated, we consider users may, given the choice, prioritise fulfilment of WIRP obligations first.¹¹⁷ Assuming this, and faced with lower than expected volumes, the use of WIRP access entitlements may lead to an under-utilisation of existing access entitlements resulting in:

- under a system premium approach — every user in the system (WIRP and non-WIRP) bears the take-or-pay liability if the system take-or-pay is triggered due to WIRP volumes failing to materialise
- under a separate tariff approach — take-or-pay may only be triggered in the existing system but not the WIRP system. This means:
 - existing users would bear the extent of any under-recovery of the system revenue cap caused by WIRP users choosing to use WIRP, over existing, access entitlements
 - WIRP users with only WIRP (no existing) access entitlements, would be shielded from this volume and substitutability risk.

We are of the view that without a rule that prioritises WIRP users' existing train service entitlements over WIRP entitlements for billing purposes, existing users could effectively bear the down-side risks associated with WIRP volumes, particularly under the separate tariff approach.

Beyond the 2014 DAU period, there could be an increase in volumes transferred from other destinations to WICET as contracted access volumes increase, and/or if coal market conditions worsen. WIRP customers could still have the incentive to transfer coal railings from other destinations to WICET, and this could lead to a further significant increase in existing (non-WIRP) users' access charges.

We have considered that prioritisation of access entitlements for billing purposes may be an option. We would welcome stakeholder views on this matter, including whether there is any appetite for such an option to be implemented and, if so, what rule would be most appropriate.

Complexity, transparency and certainty

We consider establishing a separate reference tariff is more complicated than adopting the socialised or system premium approach as it results in the creation of a set of additional system tariffs. However, we consider this to be a lesser concern given this approach has a precedent in the form of pricing arrangements for GAPE train services. In general, although more complex, separate tariffs are more transparent and provide greater certainty in terms of cost reflectivity than socialised tariffs. However, transparency issues arise mainly in how to determine incremental volumes in a system where train services are substitutable.

5.5.1 Evaluation of options against the criteria

Our analysis is summarised in the table below. In this table, we have evaluated the three options against our assessment criteria.

¹¹⁷ Due to more stringent take-or-pay obligations at WICET.

Table 14 Comparison of potential options for pricing WIRP train services in the Blackwater and Moura systems

<i>Approach</i>	<i>Supporting points</i>	<i>Opposing points</i>
Socialised pricing (system reference tariff applied to all WIRP and non-WIRP users)	<ul style="list-style-type: none"> • Ease of application as everyone pays the same tariff and avoids complexities associated with creating a new system for WIRP. • Would avoid the issue of substitutability of WIRP train services as both WIRP and non-WIRP train services pay the same tariff. 	<ul style="list-style-type: none"> • Our modelling results show a socialised outcome would result in an increase in the Blackwater and Moura system reference tariffs for existing users. • Existing users will be exposed to the volume risk associated with WIRP users. If WIRP is under-utilised or WIRP users under-rail, under-recoveries may be shared across all users via revenue cap mechanisms.
System premium (partial socialisation)	<ul style="list-style-type: none"> • Ease of application as partial socialisation results in the same tariff being applied for most customers. Also, avoids complexities with creating a new system for WIRP. • WIRP users, as a group, pay an access charge that reflects at least the full incremental costs of access. 	<ul style="list-style-type: none"> • The substitutability of train services means that we cannot derive a true measure of WIRP incremental volumes. • Existing users will be exposed to the volume risk associated with WIRP users. If WIRP is under-utilised or if WIRP users under-rail, under-recoveries will be shared across all users via revenue cap mechanisms.
Separate reference tariff	<ul style="list-style-type: none"> • WIRP users, as a group, pay an access charge that reflects at least the full incremental costs of access. • Consistent with positions we have established previously, including our position regarding GAPE train services. 	<ul style="list-style-type: none"> • The substitutability of train services means that we cannot derive a true measure of WIRP incremental volumes. • The substitutability of WIRP train services means that part of this volume risk associated with WIRP train services may still be effectively passed to existing users. If WIRP users prioritise WIRP over non-WIRP train services, this could lead to under-railings in the existing system being recovered from a smaller group of users than under a system premium approach.

5.5.2 Conclusion

Based on an analysis of all available information, and having regard to the factors set out in section 138(2) of the QCA Act, we do not consider that it is appropriate to fully socialise WIRP costs within the existing coal systems. We consider that WIRP costs are significant and would, if added to existing system costs, result in a socialised tariff that is higher for all users, including existing users.

As such, both the system premium and separate tariff are viable options that would be consistent with economic efficiency and cost reflectivity as they allow for incremental pricing options where practical.

However, we consider the system premium option has clear advantages over separate tariffs as:

- it is less complex—it does not result in additional system tariffs
- from a volume and risk sharing perspective—while all parties share the cost and volume risk of WIRP to some extent, this approach minimises the impact volume substitutability could have on existing users.

It is our view that the proposed WIRP pricing arrangements use the system premium approach. This approach is appropriate as it takes into account, and provides a balance between, the interests of Aurizon Network, access seekers and access holders, and is generally consistent with the other factors set out in section 138(2) of the QCA Act.

Draft decision

5.1 Our draft decision is to refuse to approve the current pricing approach set out in the proposed WIRP pricing arrangements. We consider that the proposed approach is not appropriate, having regard to the factors set out in section 138(2) and given the implications of volume risk and substitutability between WIRP and non-WIRP train services. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) use a system premium pricing approach.**

6 PRICING ARRANGEMENTS FOR WIRP TRAIN SERVICES

As outlined in the previous chapter, our preferred pricing approach for WIRP train services over the 2014 DAU period is to apply a system premium, if applicable, in addition to the relevant Blackwater or Moura system reference tariffs.

In this chapter we present our proposed pricing arrangements for WIRP train services over the 2014 DAU regulatory period.

Appendix D sets out our proposed reference tariffs for 2015–16 and 2016–17 in detail (i.e. the tariff components AT_1 – AT_5 for each system) and, based on these, our proposed revenue caps for non-electric and electric access charges.

6.1 Proposed WIRP pricing arrangements

6.1.1 2014–15 WIRP train services

For the small number of WIRP train services that operate in 2014–15, and consistent with the transition arrangements proposed in Aurizon Network's December 2014 WIRP pricing proposal, we consider it appropriate that the relevant Blackwater or Moura system reference tariffs apply given:¹¹⁸

- volumes for WIRP train services are minimal and did not commence until March 2015
- the commissioning date of the WIRP infrastructure, as accepted in our MAR Draft Decision, is 2015–16 for pricing purposes.¹¹⁹

6.1.2 WIRP train services in Blackwater—2015–16 and 2016–17

Tariff derivation steps

Table 15 outlines the key steps we have taken in determining the applicable reference tariff for WIRP and non-WIRP train services in the Blackwater system.

¹¹⁸ As presented in our January 2015 Draft Decision (QCA, 2015).

¹¹⁹ This timing is also consistent with the updated WIRP capital indicator provided by Aurizon Network in its December 2014 WIRP pricing proposal, which we have accepted in this Draft Decision.

Table 15 QCA's proposed tariff derivation approach for Blackwater

<i>Step</i>	<i>QCA analysis</i>
Apply Subclause 4.1.2 of the 2010AU to existing mine-specific spur lines	As outlined in section 5.4.1, we consider that the existing Rolleston train services should continue to pay a system premium on the Blackwater system reference tariff to ensure they pay at least the incremental costs and minimum CCC attributable to their train service.
Assess whether a system premium is applicable for WIRP train services	<p>In this step, we assess whether WIRP train services should be subject to a system premium in addition to the Blackwater system reference tariff for the following train services:</p> <p>WIRP Rolleston</p> <p>Our analysis showed that the incremental cost associated with the WIRP Rolleston train service is less than the incremental cost associated with the existing (non-WIRP) Rolleston train service (on a \$/nt basis).</p> <p>However, when WIRP and non-WIRP Rolleston train services are combined, our analysis shows a higher tariff than the existing Blackwater system reference tariff (on a \$/nt basis).</p> <p>WIRP Blackwater</p> <p>When doing a similar comparison for other WIRP Blackwater customers, our analysis showed the costs associated with WIRP Blackwater resulted in a higher tariff than the existing Blackwater system reference tariff (on a \$/nt basis).</p>

WIRP Blackwater customers have a higher incremental cost, primarily because some WIRP train services are not expected to rail for the remainder of the 2014 DAU period. We consider below the appropriateness of applying a revenue deferral mechanism during this period.

Revenue deferral

In our view, there is a significant impact on the tariff for riling WIRP users if the timing of the recovery of the return on and of WIRP capital expenditure is not adjusted to reflect short-term expected low volume profiles. If the revenue recovery profile is not adjusted to reflect this, it results in a premium for all WIRP users on the Blackwater system. This premium would effectively cover the cost of WIRP users not riling. In this respect, we note that one WIRP user (Bandanna Energy Limited)¹²⁰ has gone into administration and another is not expected to rail in this regulatory period.

Against this background, we consider that it is appropriate to defer the inclusion of the capital costs of all WIRP train services not expected to rail during the 2014 DAU period.

The benefit of this approach is that customers that do rail will not be impacted by customers who are not riling. Further, the under-recovery will be capitalised at the approved 2014 DAU WACC for the remainder of the regulatory period. This ensures that Aurizon Network recovers the return on and of WIRP infrastructure over the estimated economic life of the asset in a net present value neutral manner.

As noted in Chapter 5, Aurizon Network proposed a similar arrangement in 2013 in the context of the NAPE customer share of GAPE project costs.¹²¹

We consider that this approach is in the interests of WIRP access holders as it prevents the implementation of a full cost recovery tariff during a period of potential under-utilisation (section 138(2)(e) and (h) of the QCA Act). This promotes the economically efficient operation of

¹²⁰ Aurizon Network, 2014(g): 32

¹²¹ Aurizon Network, 2013(a): 21

WIRP (which accords with the object of Part 5 of the QCA Act) by maximising the early usage of WIRP by keeping user costs down.

Further, we are of the view that this provides temporary assistance in maintaining the competitiveness of Queensland's mining industry on the global coal market, thereby seeking to minimise any potential under-utilisation. We consider this is in the public interest and aligns with object of Part 5 of the QCA Act (ss. 69E, 138(2)(a),(d) of the QCA Act).

We also consider the temporary nature of revenue deferral is consistent with the application of the pricing principles (ss. 138(g), 168(A) of the QCA Act). Indeed, the fact that Aurizon Network is able to recover the efficient costs of providing the infrastructure, including a regulated return on the investment on a net present value neutral basis, over the estimated economic life of the asset aligns with its legitimate business interests (s. 138(b) of the QCA Act).

Summary of proposed approach

In developing our proposed WIRP pricing approach, a key principle we have applied (consistent with previous pricing decisions) is the incremental up/ socialise down approach. That is, if an expansion results in higher average costs for existing users, we set a higher charge for the new user. If the expansion results in lower average costs, we apply a lower average price for all customers.

For this reason, our proposed pricing arrangements for WIRP train services are:

- for WIRP Blackwater users (excluding WIRP Rolleston users)—the Blackwater system reference tariff will apply. This tariff socialises a portion of WIRP Blackwater costs within the existing Blackwater system, while deferring the recovery of some WIRP Blackwater costs.
- for WIRP Rolleston users—a system premium in addition to the Blackwater system reference tariff will apply for both WIRP and non-WIRP Rolleston train services. This reflects the higher costs associated with Rolleston train services, including costs associated with WIRP.

This approach results in each customer grouping in the Blackwater system being allocated, to the extent practicable, the costs related to their access. In particular:

- WIRP Blackwater users (excluding WIRP Rolleston)—the allocation of the WIRP project costs attributable to the additional access rights for train services unloading at WICET, excluding Rolleston and those customers for which revenue has been deferred, as outlined above.
- Rolleston users—the total of
 - Rolleston mine-specific spur line costs plus a minimum CCC for the access rights for train services unloading at non-WICET destinations
 - the allocation of WIRP project costs attributable to the additional access rights for train services unloading at WICET
 - Rolleston electrification costs, since the incremental cost of this new electric investment results in a higher tariff than the Blackwater AT₅ tariff.
- Existing Blackwater users—all remaining costs associated with the Blackwater system. This comprises costs associated with existing Blackwater system assets, excluding Rolleston.

We have also applied the revenue smoothing factor to WIRP allowable revenue in our calculation of reference tariffs for WIRP train services.¹²²

We consider this represents a transparent and consistent approach to calculating reference tariffs in the CQCN and, as such, is in the interests of access seekers and holders (ss. 138(2)(e) and (h) of the QCA Act).

Under the system premium approach and our proposed revenue deferral:

- Rolleston train services (both WIRP and non-WIRP) will pay a system premium in addition to the Blackwater system reference tariff
- All other train services (both WIRP and non-WIRP) will pay the Blackwater system reference tariff.

We consider that this approach is appropriate over the remainder of the 2014 DAU period given the existing pricing and take-or-pay arrangements. The alternative approach of a separate reference tariff may increase the risk that non-WIRP users would face higher take-or-pay charges as a result of the substitution effect. These non-WIRP users may in effect be forced to assume the risk of under-railings, which we consider is not appropriate since these users are not best placed to manage such risk.

As outlined in our January 2015 draft decision, we consider there is merit in reviewing the existing pricing arrangements prior to UT5 with a view to making individual users more accountable for their use of contracted capacity.

Draft decision

6.1 Our draft decision is to refuse to approve Aurizon Network's proposed pricing approach for WIRP train services in Blackwater. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Apply a the pricing arrangements outlined in this chapter for WIRP users, including applying a system premium for Rolleston train services**
- (b) Address the impact of WIRP customers that are not expected to rail during the 2014 DAU period, by application of our proposed revenue deferral mechanism to address the impact on expanding users resulting from the underutilisation of WIRP capacity over the remainder of the 2014 DAU period.**

6.1.3 WIRP train services in Moura

On the basis of the analysis in Chapter 5, we also consider the application of a system premium for WIRP train services in Moura to be appropriate in order to ensure WIRP users pay efficient costs and to minimise the impact on existing Moura customers.

While this approach differs to that proposed by Aurizon Network in its 2014 DAU, it is consistent with the approach put forward by Aurizon Network in its December 2014 WIRP pricing proposal.

¹²² This approach derives a smoothed revenue profile over 2015–16 and 2016–17 with an equivalent present value as the unsmoothed revenue stream. Aurizon Network proposed this in both its 2014 DAU and its December 2014 WIRP pricing proposal.

We do not consider that a revenue deferral mechanism is appropriate in this case as the system premium reflects the share of WIRP project costs attributable to the one WIRP customer in Moura. Hence, any price changes due to under-railing of WIRP volumes would not affect other WIRP users (as is the case in the Blackwater system where there are multiple WIRP users). In the Moura system, the risk of under-railings would flow to the party that is best placed to manage this risk.

We consider that a transparent, certain and consistent approach to calculating reference tariffs in the CQC is in the interests of access seekers and holders (ss. 138(2)(e) and (h) of the QCA Act).

Draft decision

6.2 Our draft decision is to refuse to approve Aurizon Network's proposed pricing approach for WIRP train services in Moura in its 2014 DAU. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Apply a system premium for WIRP Moura train services consistent with the pricing arrangements outlined in this chapter.**

6.1.4 WIRP train services—NCL

We recognised the unique circumstances of the Colton to Gladstone Port train service in our March 2012 final decision on Aurizon Network's proposed alternative access charge for this train service. In particular, the rationale for an alternative approach to developing a reference tariff for this train service had regard for the unusual characteristics of this train service, including:

- the relatively short (eight kilometre) section of Aurizon Network's rail network being used
- use of significantly shorter trains than those operating on the Blackwater and Moura systems.

We consider that the pricing arrangements do not appear to adversely impact on existing access holders' rights and entitlements. We consider that strict application of undertaking requirements would likely lead to an adverse outcome for the Colton customer, without providing any benefits to existing access holders.¹²³

We also note that the CCC calculation outlined in Subclauses 4.1.1 and 4.1.2 of the 2010 AU do not appear reasonable for Colton, as the train service will only use a short distance of track. We accept the escalation of the existing CCC for Colton train services, but consider a more appropriate escalation factor to be CPI, consistent with our escalation of many other cost components.

As a consequence, we consider that it is appropriate to refuse to approve Aurizon Network's approach to pricing arrangements for WIRP_NCL, and to recommend that the escalation factor used be amended to be in accordance with CPI over the 2014 DAU regulatory period.¹²⁴

¹²³ No stakeholder has provided any reasons to oppose Aurizon Network's proposed pricing approach.

¹²⁴ We note these prices have been developed using contracted volumes, consistent with the pricing approach in our final decision on the Colton train service (QCA, 2012(e)).

We consider this to balance the interests of Aurizon Network and access seekers/holders under section 138(2) of the QCA Act, and to be consistent with the application of the pricing principles (ss. 138(g), 168(A) of the QCA Act).

Draft decision

6.3 Our draft decision is to refuse to approve Aurizon Network's proposed pricing approach for WIRP_NCL train services from Colton. We consider it appropriate to do so having regard to each of the matters set out in section 138(2) of the QCA Act for the reasons set out in our analysis above. The way in which we consider it is appropriate to amend the 2014 DAU is as follows:

- (a) Apply the approach outlined in Aurizon Network's December 2014 WIRP pricing proposal, with the CCC for WIRP_NCL train services escalated in accordance with CPI over the 2014 DAU regulatory period.**

GLOSSARY

2010 AU	Aurizon Network's current Access Undertaking, approved by the QCA on 1 October 2010, together with any subsequent changes approved by the QCA
2013 DAU	Aurizon Network's 2013 Draft Access Undertaking, submitted on 30 April 2013, withdrawn on 11 August 2014
2013 SUFA DAAU	Aurizon Network's 2013 Standard User Funding Agreement (SUFA) Draft Amending Access Undertaking, submitted on 22 July 2013
2014 DAU	Aurizon Network's 2014 Draft Access Undertaking, submitted on 11 August 2014 and replacing the 2013 DAU

A

AT ₁	Is the incremental maintenance tariff specified as AT ₁ for the nominated reference train service (levied on a \$/'000 gross tonne kilometre basis)
AT ₂	Is the incremental capacity tariff specified as AT ₂ for the nominated reference train service (levied on a \$/train path basis)
AT ₃	Is the allocative part of the reference tariff for the nominated reference train service – it can be adjusted by way of an addition (system premium) or subtraction (system discount), where applicable (levied on a \$/'000 net tonne kilometre basis)
AT ₄	Is the allocative part of the reference tariff for the nominated reference train service (levied on a \$/net tonne basis)
AT ₅	Is the electric access tariff for the nominated reference train service (levied on a \$/'000 electric gross tonne kilometre basis)
Aurizon Group	The Group of Companies held by Aurizon Holdings Limited, which includes Aurizon Network Pty Ltd
Aurizon Holdings	Aurizon Holdings Limited
Aurizon Network	The below rail infrastructure business (formerly known as QR Network Pty Ltd) which owns and operates the below rail network in the CQCR and is responsible for negotiating access with parties seeking to use its rail network

B

BMA	BHP Billiton Mitsubishi Alliance
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C

CCC	Contribution to common costs
CCCSC	Capricornia Coal Chain Steering Committee
CPI	Consumer price index
CQCN	Central Queensland Coal Network
CQCR	Central Queensland Coal Region
CRIMP	Coal Rail Infrastructure Master Plan

D

DAAU	Draft Amending Access Undertaking
DAU	Draft Access Undertaking
Draft Decision	WIRP Supplementary Draft Decision (this Draft Decision)

E

F

G

GAPE	Goonyella to Abbot Point Expansion
GCEE	Gladstone Coal Export Executive
gtk	Gross tonne kilometres

H

I

IDC	Interest During Construction
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J

JT Boyd	John T Boyd Company
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K

L

M

MAR	Maximum Allowable Revenue
mt	Million tonnes

N

NAPE	Newlands to Abbot Point Expansion
NCL	North Coast Line
NMP	Network Management Principles
nt	Net tonnes
ntk	Net tonne kilometres

O

P

Q

QCA	Queensland Competition Authority
QCA Act	<i>Queensland Competition Authority Act 1997 (Qld)</i>
QR	Queensland Rail Limited
QR Network	the subsidiary of QR which was established in 2008 to own and manage the CQCN, now Aurizon Network
QRC	Queensland Resources Council

R

RTCA	Rio Tinto Coal Australia
RTI	<i>Right to Information Act 2009 (Qld)</i>

S

T

U

UT1	the period from 2001 to 2006, being the term of QR's first access undertaking covering the CQCN
UT2	the period from 2006 to 2010, being the term of QR's second access undertaking covering the CQCN
UT3	the period from 2010 to 2015, being the term of the 2010 Access Undertaking (as extended), being the third access undertaking covering the CQCN
UT4	the four year period commencing 1 July 2013, being the proposed term of the 2014 Access Undertaking, which will be the fourth access undertaking covering the CQCN
UT5	the undertaking period following the conclusion of UT4, noting UT5 has yet to be proposed by Aurizon Network

V

W

WACC	Weighted Average Cost of Capital
WICET	Wiggins Island Coal Export Terminal
WIRP	Wiggins Island Rail Project, involving a series of individual rail infrastructure projects, creating a link between mines in the southern Bowen Basin and WICET.
WIRP Stage 1	The first stage of WIRP, including construction of new and upgraded infrastructure to support train services to WICET.

X

Y

Z

APPENDIX A: WIRP TIMELINE AND KEY MILESTONES

Proponents of WIRP were first proposed by Aurizon Network in 2008 as part of the 2008 Coal Rail Infrastructure Master Plan (CRIMP) process.

The events relevant to our consideration of WIRP therefore commence in 2008 and extend through to the finalisation of the WIRP commercial arrangements in 2011. These events include:

- CRIMP presentations and documents distributed to coal customers
- letters, documents and information flows between Aurizon Network, existing rail operators and coal customers on the Blackwater system, the Gladstone Coal Export Executive (GCEE) and prospective coal customers participating in the WIRP negotiation process
- different understandings which arose from the information flows between the Blackwater coal customers, the GCEE and the WIRP customers.

From the material provided to us, our understanding of the various events in relation to WIRP over that period is summarised in Table 1 below.

Table 1 WIRP timeline of key events and milestones

<i>Date</i>	<i>Description</i>
CRIMP	
Oct 2008	<p>The 2008 CRIMP was released to existing users. It outlined the proposed scope and rationale for upgraded rail infrastructure in the Blackwater system.</p> <p>This included, firstly, a project to complete two duplications¹²⁵ to ensure sufficient capacity to allow for the implementation of new possession regimes during the UT3 period.¹²⁶</p> <p>A separate project proposed an additional five duplications¹²⁷ to:</p> <ul style="list-style-type: none"> • provide greater robustness to handle unforeseen variability in the system • reduce the impact of track maintenance and construction (including for the new UT3 track maintenance regime yet to be modelled) • allow for construction of the duplications to be programmed in the most efficient way • facilitate the WICET project for coal customers looking to expand their coal operations.¹²⁸ <p>Aurizon Network identified the seven duplications would need to be completed by 2012 and sought customer endorsement on all duplications.</p>
Dec 2008	Aurizon Network received customer endorsement for all seven duplications in the Blackwater system.
Feb 2009	Aurizon Network sought QCA regulatory pre-approval of 17 projects endorsed by customer vote under Aurizon Network's 2008 CRIMP. We pre-approved the scope for 13 of these projects, including the Blackwater duplication projects, and deferred our pre-approval for the remaining four projects (not related to WIRP).
Apr 2009	Aurizon Network sought, and gained, QCA regulatory pre-approval for the scope of the remaining four projects (not related to WIRP) endorsed by customer vote under the 2008 CRIMP.

¹²⁵ These two duplications comprised Rocklands – Gracemere and Walton – Bluff.

¹²⁶ Aurizon Network, CRIMP 2008: 93

¹²⁷ These comprised Kabra – Gracemere, Stanwell – Kabra, Dingo – Umolo and Walton – Parnabal – Umolo.

¹²⁸ Aurizon Network, CRIMP 2008: 99

Date	Description
Oct 2009	<p>The 2009 CRIMP was released to customers. It proposed to complete all Blackwater duplications progressively between 2010 and mid 2013:</p> <ul style="list-style-type: none"> • Aurizon Network indicated seven duplications were considered as 'base case' for future tonnages scenarios, with two duplications being attributed to Blackwater system robustness and five duplications being attributed to the WICET expansion <p>Aurizon Network did not trigger another customer vote and proceeded on the basis of the 2008 CRIMP customer vote and QCA endorsement.</p>
Oct 2010	<p>The 2010 CRIMP was released to customers. It proposed:</p> <ul style="list-style-type: none"> • proceeding with only three of the Blackwater duplications for WIRP • the remaining four duplications being listed under future long-term growth options.¹²⁹ <p>Aurizon Network did not trigger another customer vote and continued to proceed on the basis of the 2008 CRIMP customer vote and QCA endorsement.</p>
Aurizon Network / existing user engagement	
Aug 2008	Aurizon Network included four Blackwater mainline duplications ¹³⁰ in its UT3 capital indicator submitted as part of its 2009 DAU proposal. ¹³¹
Sep 2009	Some existing Blackwater users expressed concerns to Aurizon Network regarding the delays to the completion of some of the approved Blackwater duplications, and sought clarification on the cause of these delays.
Feb 2010	Aurizon Network amended its proposed UT3 capital indicator (via submission on our 2009 DAU Draft Decision) to remove the costs of four Blackwater mainline duplications that it said were now only required to support additional volumes associated with WICET. ¹³²
Mar 2010	The GCEE (representing existing users) wrote to Aurizon Network expressing concerns at the delay in the Blackwater duplication program, reflected in the removal of Blackwater duplications from the UT3 capital indicator. The GCEE requested that Aurizon Network give serious consideration to reinstating its original duplication program. ¹³³
May 2010	<p>In response to the GCEE, Aurizon Network said capacity modelling assumptions continue to be reviewed to facilitate the expansion of export capacity at Gladstone (which includes RG Tanna, Barney Point and WICET).</p> <p>The new assumptions indicated that three duplications (Rocklands – Gracemere, Gracemere – Kabra and Walton – Bluff) were required to support Wiggins Island phase 1 (the remaining duplications were still in the concept stage).</p>
Oct 2010	The GCEE wrote to the Queensland Treasurer and Minister for Transport expressing concerns over the continued delay by Aurizon Network in undertaking the approved Blackwater duplications, and urged that the program be recommenced. The GCEE said that despite Aurizon Network receiving customer endorsement to complete these duplications, and the reasons for doing so remaining valid, none of the work had yet commenced. ¹³⁴
Nov 2010	In response to the October 2010 letter from the GCEE, the Queensland Treasurer said based on the information provided by Aurizon Network, it would appear that the requirement and timing for the duplications in the Blackwater system, as detailed in the 2008 CRIMP, were no longer relevant. ¹³⁵

¹²⁹ Aurizon Network, CRIMP 2010: 38, 59

¹³⁰ These comprised Rocklands – Gracemere, Walton – Bluff, Kabra – Gracemere and Stanwell – Kabra.

¹³¹ QR Network 2009 DAU, Volume 2 Attachments, August 2008: 14

¹³² QR Network 2009 DAU, Response to QCA draft decision, Volume 2 – Pricing related matters: 37–39

¹³³ GCEE, letter to QR Network Access, 26 March 2010.

¹³⁴ GCEE, letter to Treasurer and Minister for Employment and Economic Development) and Minister for Transport, 12 October 2010.

¹³⁵ Treasurer and Minister for Employment and Economic Development, letter to GCEE, 17 November 2010.

Date	Description
Dec 2010	<p>Aurizon Network advised the GCEE that:</p> <ul style="list-style-type: none"> the seven duplications in the Blackwater system, as detailed in the CRIMP 2008, were not required for current Blackwater capacity and instead were required for capacity expansion associated with WICET developments three Blackwater duplications, or potentially four, would be required for WICET Stage 1 (pending final capacity assessments). the remaining duplications to be developed as demanded (i.e. such as WICET Stage 2 or Stage 3).¹³⁶
Dec 2010	<p>The GCEE acknowledged Aurizon Network's position that the approved Blackwater duplications were not required for current Blackwater capacity. However, the GCEE considered that it would be beneficial to have the Blackwater duplications completed in the short term to minimise disruptions due to construction prior to an expected surge in raiing requirements. The GCEE said they would be willing to consider the inclusion of the duplication costs in the RAB, despite the fact they might be built earlier than would otherwise be the case.¹³⁷</p>
Nov 2014	<p>The Capricornia Coal Chain Steering Committee (CCCSC), comprised of incumbent Blackwater users, supported the acceleration of completion timeframes for the delivery of the Blackwater duplications.</p>
Aurizon Network / WIRP user group engagement	
Early 2010	<p>Aurizon Network engaged with end users who were seeking capacity at WICET and therefore required new or additional train service entitlements on the CQCN. Aurizon Network also began discussions regarding access conditions for the construction of WIRP.</p>
Dec 2010	<p>Aurizon Network advised WIRP user group that a minimum of five duplications would be required for WICET, but potentially seven based on:</p> <ul style="list-style-type: none"> revised operating assumptions and modelling an increase in existing Blackwater capacity requirements from new agreements.
May 2011	<p>Aurizon Network provided us with a report seeking approval of WIRP access conditions in accordance with the 2010 AU. WIRP access conditions included a fee)to address additional risks Aurizon Network said it faced in relation to WIRP.</p> <p>The WIRP scope, as set out in the report to us, included all seven Blackwater duplications.</p>
Jun 2011	<p>Existing Blackwater customers provided submissions to us on Aurizon Network's access conditions report. Existing customers considered that they should not bear risks for which Aurizon Network received compensation via the WIRP fee. Existing customers said:</p> <ul style="list-style-type: none"> the access conditions would create an adverse regulatory precedent, possibly impacting on their access prices and resulting in the existing Blackwater users (and not Aurizon Network) bearing the asset stranding risk of WIRP non-WIRP customers should not bear any of the WIRP commercial risks and costs for which they receive no benefit, including if a WIRP customer defaults during the term of the access agreement, then any remaining asset liability should not be recovered from existing non-WIRP customers¹³⁸ the access charges for non-WIRP customers on existing volumes should not increase as a result of the WIRP investment.
Sep 2011	<p>Aurizon Network advised access conditions had been agreed with all WIRP customers, with conditional agreements executed.</p> <p>At the same time, it sought our approval of the access conditions.</p>

¹³⁶ QR National, letter to GCEE, 20 December 2010.

¹³⁷ GCEE, letter to QR National, 24 December 2010.

¹³⁸ QCA, 2012(d): 7

Date	Description
Apr 2012	We released a draft decision to approve the access conditions.
May 2012	<p>We made a final decision to approve the access conditions. Given that all WIRP users agreed to Aurizon Network's access conditions, clause 6.5.4(e) of the 2010 AU required that we approve the proposed access conditions unless the access conditions are contrary to public interest or stakeholders are disadvantaged by the access conditions.</p> <p>In response to concerns from existing users that the costs of the WIRP project would be borne by all users through reference tariffs and potential defaults, we said that these concerns would be addressed as part of the WIRP reference tariff application process.¹³⁹</p>
WIRP pricing arrangements	
April 2013	Aurizon Network, as part of its proposed 2013 DAU, submitted proposed Blackwater and Moura system reference tariffs which socialised WIRP infrastructure costs. Aurizon Network said that the socialisation of the WIRP project costs lowered the average Blackwater access charge. ¹⁴⁰
Aug 2014	<p>Aurizon Network provided us with a supporting submission that outlined its revenue and pricing treatment of WIRP in its 2014 DAU submission. Aurizon Network said this submission provided further information to support its proposal to socialise WIRP within the Blackwater and Moura system.¹⁴¹</p> <p>Aurizon Network proposed that one-seventh of the capital costs of the Blackwater duplications should be allocated to existing Blackwater customers for the purpose of assessing the impact of socialisation of the cost of WIRP infrastructure.</p>
Nov 2014	<p>In response to stakeholder submissions, we asked Aurizon Network for a more comprehensive tariff proposal for WIRP that provides:</p> <ul style="list-style-type: none"> • more recent estimates of costs and volumes • the rationale for Aurizon Network's proposed allocation of WIRP costs • further justification for Aurizon Network's proposed socialisation of WIRP.
Dec 2014	<p>Aurizon Network submitted to the QCA its proposed WIRP reference tariffs pursuant to clause 6.4.2 of the 2010 AU. Aurizon Network said that it considered it appropriate to apply 2010 AU reference tariff pricing processes, since this was the applicable undertaking at the time the decision to invest was made, and is currently in force.¹⁴²</p> <p>Aurizon Network proposed the capital costs of the Blackwater duplications be shared equally between WIRP and non-WIRP users (i.e. on a 50/50 basis) on the basis they:</p> <ul style="list-style-type: none"> • will enhance the robustness and reliability of the Blackwater system, delivering considerable operational efficiencies • will be utilised extensively by both WIRP and non-WIRP users • were desirable by non-WIRP users and received QCA pre-approval of scope in the absence of committed WIRP capacity..
April 2015	We approved transitional tariffs for WIRP train services to apply for 2014-15.
June 2015	We approved extending the 2010 AU until 29 February 2016, including transitional reference tariffs for WIRP and all other coal-carrying train services on the CQCR.

¹³⁹ QCA, 2012(d): 10–11

¹⁴⁰ Aurizon Network, 2013 DAU, sub. no. 3: 25

¹⁴¹ Aurizon Network, 2014 DAU, sub. no. 6: 2

¹⁴² Aurizon Network, 2014(g): 5–6

APPENDIX B: RISKS AND THE WIRP FEE

WIRP – risks and the WIRP fee

This table provides a summary of the risks associated with WIRP, as stated by Aurizon Network. On the basis of these risks, it negotiated and agreed to access conditions with WIRP users.

Table 1 Aurizon Network's stated risks mitigated by the WIRP fee¹⁴³

<i>Risk</i>	<i>Description</i>
Construction	The commercial terms for WIRP were developed with significant customer group input that imposes specific target costs and budgets. This requires QR Network to assume a higher degree of risk in the project delivery due to the scale of the project and because it is being undertaken in conjunction with other major supply chain construction projects.
Credit	With a large number of smaller coal producers in the customer group, there is a risk of non-performance by a customer, (e.g. failure to make a payment or outright default) and QR Network cannot socialise the costs of any defaults among other users – there is also a credit risk associated with recovery of the WIRP fee payments.
Optimisation	QR Network's risk of the QCA not accepting assets into the regulatory asset base due to it complying with a customer agreed procurement strategy.
Asset stranding	During the term of the agreements or at the expiry of the agreements, if a material proportion of the project is unrecovered (including the return on the investment) and market demand falls, this could trigger an optimisation event.
Financing	That QR Network cannot secure financing, or it can but on unfavourable terms, which could be significant given the size of the project (i.e. QR Network will have to raise around \$900 million over three years). There is also a risk of variations between regulatory approved cost of capital and actual financial charges imposed on QR Network.
Performance	The WIRP fee is not payable if QR Network is unable to provide access at the contracted levels and QR Network cannot recoup this loss via the revenue cap.

¹⁴³ QCA, 2012(c): 4-5

APPENDIX C: SUMMARY OF QCA PROPOSED CHANGES TO COST AND VOLUME ASSUMPTIONS

Table 1 Summary of QCA proposed changes to Aurizon Network's 2014 DAU cost and volume assumptions

<i>Item</i>	<i>Issue</i>	<i>Aurizon Network 2014 DAU proposal</i>	<i>QCA Draft Decision</i>	<i>Rationale for QCA proposed change</i>
1	Capital indicator for WIRP related projects	Aurizon Network proposed an updated 2014 DAU mid-year capital indicator for WIRP of \$949.7 million, inclusive of IDC. ¹⁴⁴ Aurizon Network's December 2014 WIRP pricing proposal provided an updated mid-year WIRP capital indicator of \$945.3 million, inclusive of IDC. ¹⁴⁵	We propose to accept Aurizon Network's updated WIRP capital indicator as provided in its December 2014 WIRP pricing proposal.	In November 2014, we requested updated capital expenditure estimates for WIRP to be provided as part of a comprehensive tariff proposal for WIRP train services. We also consider the updated WIRP capital indicator is consistent with our Draft Decision on the MAR in terms of calculating the IDC.
2	Allocation of North Coast line project costs between WIRP users	In its 2014 DAU proposal, Aurizon Network allocated this expenditure only to WIRP customers located in Blackwater. However, in its December 2014 proposal it allocated this expenditure to all WIRP customers. ¹⁴⁶	We propose to accept Aurizon Network's proposed capital cost allocation approach for WIRP customers as incorporated in its 2014 DAU.	We consider this to be consistent with the commercial arrangements between Aurizon Network and WIRP users, reflecting agreement between Aurizon Network and each WIRP customer on the incremental capital cost attributable to the particular customer.
3	Allocation of Blackwater duplications project costs to non-WIRP users	In its 2014 DAU proposal, Aurizon Network allocated one-seventh of Blackwater duplication costs to existing customers. ¹⁴⁷ By contrast, in its December 2014 WIRP pricing proposal, Aurizon Network proposed to allocate 50 per cent of Blackwater duplication costs to existing customers. ¹⁴⁸	We propose to refuse to approve either of Aurizon Network's proposed allocations of Blackwater duplication costs to existing users. Instead, we have not allocated any of the Blackwater duplications costs to existing customers.	We do not consider Aurizon Network's proposed allocations are reasonable given: <ul style="list-style-type: none"> neither Aurizon Network or WIRP customers has provided any clear evidence to support or justify either of these allocations at the time of the investment decision, we understand that capacity modelling showed that Blackwater duplications were only required in the

¹⁴⁴ Aurizon Network December 2013 Financial Model

¹⁴⁵ Aurizon Network, December 2014: 17

¹⁴⁶ Aurizon Network December 2014 WIRP Financial Model

¹⁴⁷ Aurizon Network, 2014 DAU, sub. no. 6: 3

¹⁴⁸ Aurizon Network, December 2014: 20

<i>Item</i>	<i>Issue</i>	<i>Aurizon Network 2014 DAU proposal</i>	<i>QCA Draft Decision</i>	<i>Rationale for QCA proposed change</i>
				presence of WIRP train services.
4	Allocation of Wiggins Island balloon loop between WIRP users	In its 2014 DAU proposal, Aurizon Network allocated these costs between WIRP customers based on contract gtk at full utilisation. ¹⁴⁹ Aurizon Network proposed a similar approach in its December 2014 WIRP pricing proposal. ¹⁵⁰	We propose to refuse to approve Aurizon Network's proposed capital cost allocation. In addition to the WIRP customers, we have also allocated a portion of the Wiggins Island balloon loop costs to existing Blackwater train services.	Our proposed allocation reflects the expected use of this infrastructure by existing Blackwater train services as reflected in WIRP commercial arrangements.
5	WIRP operating costs	In its 2014 DAU proposal, Aurizon Network allocated system operating costs to WIRP based on WIRP gtk as a proportion of total system gtk. ¹⁵¹ In its December 2014 WIRP pricing proposal, Aurizon Network proposed zero incremental operating costs for WIRP train services. ¹⁵²	We propose to accept Aurizon Network's December 2014 proposal which presented zero incremental operating costs for WIRP train services.	We are not convinced that Aurizon Network's 2014 DAU proposal to allocate operating and maintenance costs between new and existing customers on a gtk basis is consistent with the concept of incremental costs. We agree with Aurizon Network's proposition in its December 2014 proposal that incremental operating costs for WIRP train services should be immaterial.
6	WIRP maintenance costs	In its 2014 DAU proposal, Aurizon Network allocated system maintenance costs to WIRP based on WIRP gtk as a proportion of total system gtk. ¹⁵³ In its December 2014 WIRP pricing proposal, Aurizon Network significantly reduced its allocation of maintenance costs to WIRP train services. ¹⁵⁴	We propose to accept Aurizon Network's December 2014 incremental maintenance costs for WIRP train services.	We have assessed Aurizon Network's approach to forming its incremental maintenance estimates and consider that the estimates are derived on a consistent basis to the direct maintenance costs we assessed in our MAR Draft Decision
7	WIRP related volumes (including volumes for existing Blackwater and Moura train	In its 2014 DAU proposal, Aurizon Network proposed that volume forecasts for WIRP train services be set at 90 per cent of	We propose to refuse to approve Aurizon Network's proposed volume forecasts. We propose to adopt the forecast volumes for	We consider Energy Economics' forecasts to be the best available as they are based on more up-to-date information and a bottom-up approach to developing

¹⁴⁹ Aurizon Network, 2014 DAU, sub. no. 6: 4

¹⁵⁰ Aurizon Network, December 2014: 19

¹⁵¹ Aurizon Network, 2014 DAU, sub. no. 6: 4

¹⁵² Aurizon Network, December 2014: 22

¹⁵³ Aurizon Network, 2014 DAU, sub. no. 6: 4

¹⁵⁴ Aurizon Network, December 2014: 22

Item	Issue	Aurizon Network 2014 DAU proposal	QCA Draft Decision	Rationale for QCA proposed change
	services)	<p>contracted tonnages through WICET in the relevant year.¹⁵⁵</p> <p>In its December 2014 WIRP pricing proposal, Aurizon Network proposed:</p> <ul style="list-style-type: none"> • for WIRP train services in Blackwater, to adopt the mid-case volume forecasts developed by JT Boyd • for WIRP train services in Moura, to adopt a lower forecast than that proposed by JT Boyd, to reflect discussions with the relevant customer with deferring their contracted volume ramp-up.¹⁵⁶ 	<p>WIRP and non-WIRP train services consistent with Energy Economics' forecasts and the adjustments to cap WIRP volumes to contracted volumes.</p> <p>We also propose to adopt updated volume information including mine-to-port distances, consists and diesel traffic percentages based on Aurizon Network's December 2014 WIRP pricing proposal.</p>	<p>forecasts at an individual mine level. In addition, we consider the Energy Economics' forecasts are more transparent, with visibility of WIRP forecasts and the underlying justification for all affected stakeholders.</p> <p>Energy Economics' forecasts also take into account transfers of forecast tonnages between existing train services and WIRP train services.</p> <p>In terms of our adjustment to cap WIRP volumes, we consider that prices for WIRP train services should reflect the use of train service entitlements in WIRP access agreements, and consider that this negotiated ramp-up reflects a cap to the shifting of tonnages to WIRP.</p>
8	<p>Non-WIRP related assumptions, including:</p> <ul style="list-style-type: none"> • WACC parameters • Non-WIRP capital indicator • forecast CPI • opening asset value as at 1 July 2013. 	<p>Aurizon Network's proposed non-WIRP related parameters were outlined in our Draft Decision on the MAR in September 2014.</p>	<p>Aurizon Network's non-WIRP related parameters were considered in our Draft Decision on the MAR in September 2014.</p> <p>We have not updated these as part of this supplementary Draft Decision.</p>	<p>Any updates for non-WIRP related assumptions will be addressed as part of our 2014 DAU Final Decision.</p>
9	<p>Escalation rate of minimum CCC for WIRP NCL train services</p>	<p>In its 2014 DAU proposal, Aurizon Network proposed an escalation rate of 5 per cent for the minimum CCC for WIRP NCL train services.¹⁵⁷</p> <p>Aurizon Network also adopted this figure in its December 2014 WIRP pricing proposal.¹⁵⁸</p>	<p>We propose to refuse Aurizon Network's escalation rate of 5 per cent. Instead, we propose to escalate the minimum CCC by 2.5 per cent.</p>	<p>We consider a CPI escalation rate to be a more reasonable escalation factor, consistent with our escalation of many other cost components.</p>

¹⁵⁵ Aurizon Network, 2014 DAU, sub. no. 6: 5–6

¹⁵⁶ Aurizon Network, December 2014: 32

¹⁵⁷ Aurizon Network December 2013 Financial Model

¹⁵⁸ Aurizon Network, December 2014: 26

APPENDIX D: REFERENCE TARIFFS AND ALLOWABLE REVENUES

Table 1 Blackwater System Reference Tariffs (nominal)

Tariff Component	2015–16	2016–17
AT ₁ – incremental maintenance (\$/'000 gtk)	0.99	1.02
AT ₂ – incremental capacity (\$/rtp)	2,147.95	2,201.65
AT ₃ – allocative component (\$/'000 ntk)	5.60	5.85
AT ₄ – allocative component (\$/nt)	1.96	2.06
AT ₅ – electric infrastructure (\$/'000 egtk)	3.60	2.79

Notes: Existing and WIRP customers (excluding Rolleston and Stanwell) pay this system reference tariff with no system premium.

Table 2 Blackwater System Alternative Reference Tariff Components (nominal)

Tariff Component¹	2015–16	2016–17
Rolleston²		
AT ₃ – allocative component (\$/'000 ntk)	6.99	6.83
AT ₅ – electric infrastructure (\$/'000 egtk)	4.04	3.41
Stanwell		
AT ₃ – allocative component (\$/'000 ntk)	3.64	3.80

Notes: (1) These tariff components replace the equivalent reference tariff component in Table 1. (2) This includes Rolleston train services to all destinations including WICET.

Table 3 Blackwater System Allowable Revenues (\$'000, nominal)

Tariff Component	2015–16	2016–17
AT ₂ –AT ₄	289,211	320,018
AT ₅	105,090	91,343

Table 4 Moura System Reference Tariffs (nominal)

<i>Tariff Component</i>	<i>2015–16</i>	<i>2016–17</i>
AT ₁ – incremental maintenance (\$/'000 gtk)	1.84	1.90
AT ₂ – incremental capacity (\$/rtp)	643.39	659.47
AT ₃ – allocative component (\$/'000 ntk)	7.88	8.71
AT ₄ – allocative component (\$/'000 nt)	1.28	1.47

Note: Existing customers pay this system reference tariff with no system premium.

Table 5 Moura System Alternative Reference Tariff Components (nominal)

<i>Tariff Component</i> ¹	<i>2015–16</i>	<i>2016–17</i>
<i>WIRP_Moura</i> ²		
AT ₃ – allocative component (\$/'000 ntk)	11.61	11.10

Notes: (1) These tariff components replace the equivalent reference tariff component in Table 4. (2) This includes all Moura train services to WICET.

Table 6 Moura System Allowable Revenues (\$'000, nominal)

<i>Tariff Component</i>	<i>2015–16</i>	<i>2016–17</i>
AT ₂ –AT ₄	38,054	45,664

Table 7 WIRP_NCL System Reference Tariffs (nominal)

<i>Tariff Component</i>	<i>2015–16</i>	<i>2016–17</i>
AT ₁ – incremental maintenance (\$/'000 gtk)	1.84	1.90
AT ₂ – incremental capacity (\$/rtp)	1,591.32	1,587.83
AT ₃ – allocative component (\$/'000 ntk)	–	–
AT ₄ – allocative component (\$/'000 nt)	–	–

REFERENCES

Refer to 'UT4 Submissions and Reference List' for all references in this document.

This can be found on our website at www.qca.org.au/Rail/Aurizon/Intro-to-Aurizon/2014-Draft-Access-Undertaking/In-Progress/2014-DAU.