Queensland Competition Authority

Guidance paper

September 2021

Pricing of shared infrastructure for the GAPE and Newlands systems

Purpose

This guidance paper provides a high-level framework to assist Aurizon Network and its users develop an agreed approach to the pricing of shared infrastructure for the GAPE and Newlands systems, where users have expressed concerns with the current approach. Users also raised issues with the treatment of deferred NAPE capital expenditure.[1]

At this time, we consider our role in this matter is limited. Additionally, within the spirit of arrangements developed by Aurizon Network and its users as part of the 2017 access undertaking (UT5), the onus is on Aurizon Network and its users to identify and resolve matters of concern. This is particularly relevant given that Aurizon Network and its users developed an undertaking distinctly aimed at increasing stakeholder engagement and collaboration (rather than regulatory involvement) to operate effectively.

Nevertheless, we are of the view that a paper that discusses and provides guidance on relevant matters may be beneficial and encourage meaningful engagement between parties. This guidance paper is intended only to provide commentary to help facilitate discussions between the parties. It should not be taken as being definitive of the QCA's final positions on any matter. Those positions are subject to change, including with the benefit of new information.

The paper sets out (at a high level) the benefits of parties working together to develop an agreed approach, the overarching principles within which any alternative cost allocation methodology must be considered. We also identify matters stakeholders may wish to consider when discussing the appropriateness of alternative cost allocation approaches.

Background

Some of Aurizon Network's users raised concerns with elements of the current approach to the pricing of shared infrastructure during the 2021–22 annual reference tariff review.[2] Submissions focused on:

- the allocation of asset replacement and renewal expenditure between Newlands and GAPE system users
- the recovery of deferred NAPE capital expenditure.

Allocation of renewals expenditure

Aurizon Network allocates the asset replacement and renewal expenditure in the Newlands system to Newlands users via the system reference tariff. This includes the costs associated with the rail infrastructure upgraded in the Newlands system to facilitate the commencement of GAPE train services. The approach reflects, to some extent, the history and development of pricing arrangements for Newlands and GAPE train services more broadly.

---

[1] GAPE refers to the Goonyella to Abbot Point expansion project. NAPE refers to the Newlands to Abbot Point expansion. For more information, refer to GAPE DAAU project documents available on our website.

[2] We note some users have also expressed concerns during the 2020–21 annual reference tariff review and the assessment of the 2019–20 capital expenditure claim. Stakeholders' positions (and additional background information) are canvassed in more detail in submissions to these processes, which are available on the QCA website.

Several stakeholders raised concerns with this cost allocation approach and said Newlands users should not bear the full cost of asset renewals, including because:

- it is not cost reflective, as it involves Newlands customers paying for costs caused by GAPE services[3]
- the degradation of Newlands assets (and associated renewals) is accelerated by GAPE users.[4]

Aurizon Network maintains that its current approach is appropriate, resulting in efficient pricing outcomes for Newlands and GAPE customers that are consistent with UT5 pricing principles and also promote equity and fairness.[5] At the same time, Aurizon Network did not dispute that '*some* renewal of assets comprising the Newlands system has been brought forward to *some* extent by the utilisation of the GAPE services'.[6] However, it said a balance needs to be reached between the extent to which the GAPE volumes have brought forward asset renewals and the extent to which Newlands users avoided costs due to the replacement or upgrading of Newlands system infrastructure as part of the GAPE infrastructure enhancements, which were subsequently paid for entirely by GAPE services.[7] It also highlighted that the drivers of the renewals expenditure are varied.[8] Aurizon Network said the inclusion of this expenditure 'progressively transitions the price of the legacy 20TAL [tonne axle load] system to the more efficient 26TAL cost of service delivery over a long period of time'.[9]

Deferral of NAPE costs

Currently, Aurizon Network does not recover all of the costs associated with NAPE. Deferred costs have been capitalised since GAPE commenced in 2012 as a result of the demand not eventuating.

Aurizon Network said it is necessary to determine the relevant triggers or thresholds for inclusion of the deferred NAPE capex in reference tariffs, and the basis for recovery of these costs.[10] Stakeholders said we should make a decision about the recovery of the capitalised NAPE costs, given the imminent commencement of new users on the Newlands system.[11] Rio Tinto said the capitalised NAPE costs should be recovered from new Newlands users through a system premium.[12]

Benefits of a collaborative approach

Where issues such as these arise, it is our view that ideally, parties would work collaboratively to identify potential solutions. An approach agreed between parties would better reflect the collective preferences and trade-offs, in line with the spirit of arrangements agreed to under UT5.

UT5 was developed through extensive negotiation between Aurizon Network and stakeholders and reflected a step towards increased collaboration between all parties. It provides a range of industry-led solutions and processes that create a more customer-centred approach to access regulation. Such an approach, if effectively utilised, may avoid regulatory error, reduces the regulatory burden on all parties

---

[3] Glencore, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, pp. 4–5; QCoal, submission to the QCA, *Annual review of reference tariffs 2021–22*, p. 2; QRC, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, pp. 5–6.
[4] QRC, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, p. 3.
[5] Aurizon Network, submission to the QCA, *Annual review of reference tariffs 2020–21*, 27 April 2020, pp. 3–5; Aurizon Network, *Annual review of reference tariffs 2021–22*, 26 February 2021, pp. 21–30.
[6] Aurizon Network, submission to the QCA, *Annual review of reference tariffs 2021–22*, 23 April 2021, appendix A, p. 6.
[7] Aurizon Network, submission to the QCA, *Annual review of reference tariffs 2021–22*, 23 April 2021, appendix A, pp. 6–7.
[8] Aurizon Network, submission to the QCA, *Annual review of reference tariffs*, 23 April 2021, appendix A, p. 13.
[9] Aurizon Network, *Annual review of reference tariffs 2021–22,* 26 February 2021, p. 21.
[10] Aurizon Network, submission to the QCA, *Annual review of reference tariffs 2021–22—draft decision*, 10 June 2021, attachment A, p. 4.
[11] Rio Tinto, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, p. 3. See also QRC, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, p. 10.
[12] Rio Tinto, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, p. 3.

and creates opportunities for parties to explore solutions to diverse and complex issues. In this context, we consider Aurizon Network, affected parties and other users should seek to uphold this type of approach to access regulation and engage productively, with the aim of presenting an agreed solution, while making compromises that are mutually agreeable.

This type of approach accords with the fact that our role in this matter, as it now stands, is limited under UT5 and the *Queensland Competition Authority Act 1997* (Qld) (QCA Act) more generally. In particular, there is no scope for the QCA to determine cost allocations as part of the renewals strategy and budget process[13] or upcoming capital expenditure claim[14]—and very limited scope during annual compliance processes thereafter.[15] Similarly, we may only require Aurizon Network to submit a draft amending access undertaking (DAAU) if we consider that it is necessary to amend the approved undertaking to make it consistent with a provision of the QCA Act or an access code.[16] We do not consider that this matter falls within that provision.

It is therefore appropriate for Aurizon Network to work collectively with affected users, should they request this, to develop an agreed alternative approach that addresses stakeholders' concerns.

Way forward

While we approved Aurizon Network's proposal for the purposes of the 2021–22 reference tariff review, we recognise the complexity of this matter and note the issues that have been raised by some users. We consider there may be benefit from further consideration of, and possible amendments to, the pricing arrangements relating to shared Newlands infrastructure in the future.

The annual compliance processes—such as the reviews of capital expenditure and reference tariffs—have limited scope to provide for a timely and robust assessment of the pricing approaches to apply, including the allocation of renewals costs (absent any consensus on an alternative approach). Aurizon Network and its users could 'agree' to an alternative split of the renewals expenditure through these processes. However, this would require support from stakeholders in the budgeting approval phase.

Given this, it appears that, at least for the near future, any changes to the allocation methodology are more likely to be implemented by way of a voluntary DAAU submitted in accordance with section 142 of the QCA Act. We encourage Aurizon Network and affected parties to negotiate on relevant matters prior to any DAAU submission. This would help to achieve a mutually agreed outcome and would allow for a more timely consideration of the matter by us. The subsequent action taken by parties would be dependent upon the outcome of stakeholders' negotiation:

- Where Aurizon Network and affected stakeholders are able to reach an agreed outcome through negotiation—Aurizon Network can submit a DAAU to amend UT5 to reflect the agreed position or propose an agreed approach.

[13] This process does not provide for the QCA to approve a strategy and budget where there is no agreement between Aurizon Network and users. In contrast, the UT5 maintenance strategy and budget process provides for QCA involvement (and approval if agreement cannot be reached on a proposed strategy and budget).

[14] The upcoming claim (due by 31 October 2021) will require us to assess the Newlands and GAPE systems' 2020–21 renewals expenditure claim (under cl. 7A.11.6) against the end-user agreed renewals strategies and budgets approved by the RIG in February 2020.

[15] For example, we will assess the Newlands and GAPE systems' 2021-22 renewals expenditure claim (due by 31 October 2022) for prudency and efficiency (under cl. 7A.11.6) given the renewals strategies and budgets were not agreed for that year. While this might provide an opportunity for us to consider allocation issues between systems, our ability to do so would depend on the approach taken and the information available to the QCA at that time.

[16] Section 139(2) of the QCA Act.

- Where Aurizon Network seeks to propose an alternative pricing approach for us to consider, without prior agreement with stakeholders—Aurizon Network can submit a DAAU to amend UT5 to reflect its new proposed position.
- If no DAAU is submitted, the matter could be considered as part of Aurizon Network's next DAU.

Each of these scenarios involves consideration of alternative proposals under the QCA Act. The criteria under the QCA Act provide greater scope for assessing such a complex matter—whereby a decision can be made on the balance of relevant and competing factors.

Overarching framework

Any discussion on alternative approaches should have regard to the broader pricing principles applying to both the Newlands and GAPE systems.

Factors that would affect our consideration and approval of a DAAU are set out in the QCA Act. Pricing provisions in UT5 are also relevant (see the box below). This list of provisions provided is not intended to be an exhaustive or prescriptive list of the provisions that may be relevant to a DAAU assessment but simply identifies those immediately relevant principles.[17] We also discuss some of the issues or matters that we may consider in assessing a DAAU of this nature but do not canvass all possible considerations in any future DAAU assessment. The factors that the QCA considers in making any decision will entirely depend on the facts of the matter at the relevant time, including with the benefit of new information provided.

[17] We acknowledge that there may be other provisions that might also be relevant at the time of the QCA's assessment of a DAAU. Additionally, a DAAU might include changes to UT5's current provisions. This would be taken into consideration when assessing the matter.

Relevant pricing principles

QCA Act

Section 138(2) of the QCA Act states that we may approve a DAAU only if we consider it appropriate to do so having regard to:

(a) the object of Part 5 of the Act, which 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 (s. 69E).*

(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 in section 168A of the Act that provide that the price of access to a service should:

  (i) 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

  (ii) allow for multi-part pricing and price discrimination where it aids efficiency

  (iii) 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

  (iv) provide incentives to reduce costs or otherwise improve productivity

(h) any other issues the Authority considers relevant.

UT5

UT5 contains pricing principles to guide the development of access charges and reference tariffs for coal-carrying train services.

Clause 6.6.2 states that Aurizon Network must set prices that are no less than the level that will recover the expected incremental cost of providing access for that train service and no more than the level that will recover the expected stand alone cost of providing access for that train service.

Incremental costs are defined in UT5 to mean:

> *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.*

Standalone costs are:

> *Those costs that Aurizon Network would incur if the relevant Train Service(s) was (were) the only Train Service(s) provided Access by Aurizon Network, where those costs are assessed:*
>
> *(a) as the Efficient Costs; and*
>
> *(b) on the basis of the assets reasonably required for the provision of Access, and includes an allowable rate of return expressed in nominal post tax terms (with the cost of debt expressed on a before tax basis), as agreed by Aurizon Network and the QCA or, failing such agreement, as determined by the QCA.*

In assessing any DAAU submission, we will have regard to the matters listed in sections 138(2)(a)–(g). Section 138(2)(h) also provides for us to have regard to any other matter we consider relevant given the nature and scope of the subject matter. This may include consideration of:

- the interests of access holders, including whether or not they will be made worse off under any proposed approach
- the consistency of the proposed pricing approach with the current undertaking provisions, including provisions such as the expansion pricing principles outlined in part 6 of UT5 (if appropriate to consider)
- whether any consensus position/s have been reached by Aurizon Network and its users.[18]

Further, in accordance with the pricing limits outlined in UT5, prices under the proposed approach would need to be set at a level that sits between incremental and standalone costs. Given that stakeholders appear to have different views on the extent to which the renewals expenditure is incremental (as opposed to standalone), any classification of costs into either category would require appropriate justification by the parties.

Potential considerations for future pricing approaches

We acknowledge there may be a range of cost allocation approaches that would comply with the relevant pricing principles, while also addressing concerns that stakeholders have with the current approach.

Stakeholders' suggested alternative approaches include:

- Tonnage or usage-based allocation—given the assets associated with the renewals costs service both the Newlands and GAPE services, some users said the allocation should reflect incremental costs proportionate to traffic using the Newlands system shared infrastructure.[19] They put forward that these costs should be calculated on the basis of each system's share of forecast tonnes for the relevant financial year.[20]
- Attributing asset replacement expenditure on the basis of the relevant causative driver—Aurizon Network said there are numerous drivers of asset degradation (and subsequent renewals expenditure). Its view was that a tonnage or usage-based allocator will not represent an appropriate attribution. Instead, an assessment of the relevant causative drivers of asset renewals expenditure is required.[21]
- In regard to NAPE costs—some stakeholders suggested a system premium be put in place to recover the capitalised NAPE costs.

We have not formed a view on whether any alternative approach would better address the interests of Aurizon Network and its users. It is a matter for the parties to consider what pricing methodology would be appropriate, in the context of their own commercial interests. However, the methodology should be robust, transparent and, where possible, cost reflective.

In assessing potential cost allocation approaches, Aurizon Network and its users may wish to consider:

- the impact of any changes to the cost allocation approach on current and future users of both systems—including on their use of the infrastructure and their longer-term investment incentives

---

[18] We would form a view on the appropriateness of considering these matters following consideration of submissions from the parties on these issues.
[19] QCoal, submission to the QCA, *Annual review of reference tariffs 2021–22*, 27 March 2020, p. 2; Rio Tinto, submission to the QCA, *Annual review of reference tariffs 2021–22*, 9 April 2021, p. 2.
[20] Rio Tinto, submission to the QCA, *Annual review of reference tariffs 2021–22*, 27 March 2020, p. 1.
[21] Aurizon Network, submission to the QCA, *Annual review of reference tariffs 2021–22*, 23 April 2021, appendix A, p. 13.

- the costs to Newlands system users of volumes originating from the GAPE system—including whether, and the extent to which, the timing of asset renewals are affected by GAPE volumes. The relevant cost drivers of asset renewals expenditure may need to be identified
- the benefits to Newlands system users of volumes originating from the GAPE system—benefits such as above-rail competition, improved service provision and pathing, and increased productivity, while often unable to be accurately quantified, may be relevant
- the extent to which expenditure associated with infrastructure replacement was avoided by Newlands users—GAPE infrastructure enhancements, paid for entirely by GAPE services, included the replacement and upgrade of aspects of the Newlands system infrastructure
- the size of the impact of changes to the cost allocation approach—where tariff changes may need to be phased over a period of time to manage the effect on stakeholders, if the impact is substantial
- the implications of any changes to the cost allocation approach in both the immediate future and the longer-term—noting that the impacts may change over time as relative volumes change or when renewals expenditure grows
- the appropriateness of seeking expert, impartial engineering input—noting that engineering analysis or advice may be useful in assessing any potential cost allocation methodologies.

Similarly, for the future treatment of deferred NAPE costs, parties may wish to consider the basis and timing for recovery of the deferred amounts, taking into account any relevant matters (e.g. the benefits parties have received, or will receive, from the related upgrades and the extent to which the deferred amounts have been recovered under relevant access agreements or access arrangements).

Overall, any approach put to us by way of a DAAU submission will involve consideration under the QCA Act. We acknowledge that the information provided in this guidance paper may only canvas a subset of the issues relevant to any assessment by the QCA. All parties are encouraged to engage productively to identify all pertinent matters to enable a transparent and robust consideration of any proposed pricing approach.