



Draft Decision

QR's Proposed Schedule F Amendment

April 2007

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SUBMISSIONS

This report is a draft only and is subject to revision. Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (the Authority). Therefore submissions are invited from interested parties concerning its assessment of QR's Proposed Schedule F Amendments. The Authority will take account of all submissions received.

Written submissions should be sent to the address below. While the Authority does not necessarily require submissions in any particular format, it would be appreciated if two printed copies are provided together with an electronic version on disk (Microsoft Word format) or by e-mail. Submissions, comments or inquiries regarding this paper should be directed to:

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The **closing date** for submissions is 4 May 2007. The Authority will consider any submission it receives within that time.

Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (ie the complete version and another excising confidential information) could be provided. Again, it would be appreciated if each version could be provided on disk. Where it is unclear why a submission has been marked "confidential", the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt documents (within the meaning of the *Freedom of Information (FOI) Act 1989*), it cannot guarantee that submissions will not be made publicly available. As stated in s187 of the *Queensland Competition Authority Act 1997* (the QCA Act), the Authority must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the Authority is satisfied that the person's belief is justified and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the Authority may be required to reveal confidential information as a result of an FOI request.

Public Access to Submissions

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

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority's website.

PREAMBLE

This Preamble should not be read as a substitute for the detail contained in the body of the draft decision.

Background

On 30 June 2006, the Queensland Competition Authority (the Authority) approved QR's 2006 access undertaking which sets out the terms and conditions under which QR will provide access to the relevant parts of its rail infrastructure.

The access undertaking recognised that at the time it was approved, a number of matters remained unresolved, including measures to mitigate QR's exposure to coal volume risk for the central Queensland coal system. It included processes to resolve these outstanding matters over the course of 2006-07.

Consistent with those processes, QR has consulted with the Queensland Resources Council (QRC) regarding broad options for the regulatory framework and detailed processes required to support that framework. Consequently, on 28 February 2007 QR submitted proposed amendments to Schedule F of its access undertaking for the Authority's approval, in accordance with cl. 3.3 of Part B of Schedule F of the access undertaking.

The Authority published QR's proposal, invited submissions on it and received four submissions. According to the processes contained in the Part B of Schedule F of the access undertaking and its obligations under the QCA Act the Authority must approve, or refuse to approve, QR's proposal within 60 days of receiving it, or longer if agreed by QR or otherwise reasonably determined by the Authority.

Outline of Draft Decision

The Authority's draft decision is to not approve QR's proposed Schedule F amendments and the associated changes to its standard access agreements. In arriving at its decision, the Authority considered submissions from interested parties as well as QR's proposal and supporting claims.

QR's central proposal is to remove volume risk by moving from a price cap to a revenue cap, while preserving the revenue that it is entitled to earn according to the Authority's June 2006 decision. The Authority proposes to approve in principle the move to a revenue cap but has a number of concerns with the way that QR has sought to implement the revenue cap, in particular with respect to:

- the definition of System Allowable Revenue (SAR) – the Authority requires QR to adopt a definition that provides for an adjustment to the extent that QR fails to provide access due to its own default or negligence;
- the proposed revenue amounts – the Authority requires QR to amend its proposal to focus on the revenue it is entitled to earn, regardless of whether it collected that amount. For this purpose, the Authority considers that QR should be deemed to have contracted on the terms of the standard access agreement that applied on the date of execution or renewal of an access agreement; and
- the proposed system forecasts (and SAR) – the Authority requires QR to maintain current approved forecasts and SAR.

In addition, the Authority requires QR to refine and clarify the associated provisions relating to reference tariff variations required as a result of a revenue cap adjustment and the review event.

Way Forward

The Authority is aware of stakeholder concerns that the form of regulation to apply for the remainder of the regulatory period should be finalised as soon as possible and of QR's recommendation that the amendments apply from 30 June 2007. However, it is important that all stakeholders have the opportunity to comment on the Authority's draft decision.

If, following consideration of all submissions in response to the draft decision, the Authority confirms its decision not to approve QR's proposed Schedule F amendment, it will issue a notice requiring QR to submit an amended proposal within 30 days. If QR complies with that notice, the Authority will approve the resubmitted proposal if it considers it appropriate to do so having regard to s.138(2) of the *Queensland Competition Authority Act 1997* (QCA Act). In this case, the Authority could approve the resubmitted Schedule F Amendment by 30 June 2007.

If QR does not comply with the notice, or if the Authority decides not to approve QR's resubmitted proposal, the Authority could prepare its own Schedule F Amendment. Under these circumstances, the Authority would be required to publish its proposal, conduct public consultation and prepare a final decision. This could not be achieved by 30 June 2007.

Submissions

The Authority seeks submissions in relation to the draft decision. Submissions must be received by no later than 4 May 2007. The Authority will consider any submission it receives within that time.

Extension of Time to Consider this Matter

As the Authority has provided stakeholders two weeks to comment on this draft decision, the Authority will not be in a position to make a final decision on QR's proposed Schedule F amendment until after the expiry of the 60 day period referred to in clause 3.7 of Schedule F, Part B of the access undertaking. As a consequence, in accordance with clause 3.7 of Schedule F, Part B of the access undertaking, the Authority has extended the period in which it must decide whether or not to approve QR's proposed Schedule F amendment to 31 May 2007.

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1. FORM OF REGULATION

The form of regulation, pricing structure and associated incentive mechanisms implemented in a regulatory environment should promote economic efficiency, appropriate investment, revenue adequacy and the public interest, and should ensure that risks are allocated to those best able to manage them.

QR's proposed amendments sought to introduce a new regulatory framework for train services on the Central Queensland coal systems and included detailed processes to support its operation, including arrangements in relation to take-or-pay and relinquishment fees. The proposed amendments would implement a hybrid revenue cap approach to replace the hybrid price cap approach that has been adopted to date.

The Authority proposes to accept, in principle, QR's proposal to adopt a revenue cap, but requires a number of changes to the way that the revenue cap is implemented, in particular relating to the definition of system allowable revenue and the calculations of revenue amounts (see also the discussion on take-or-pay). In addition, the Authority has not accepted QR's proposal to vary system forecasts from what was approved in the 2006 access undertaking.

1.1 Revenue Cap Approach

QR Proposal

QR proposed that a hybrid revenue cap be adopted for train services on the central Queensland coal region (CQCR) from 1 July 2006. Under the proposed arrangements:

- a revenue cap is applied to the incremental capacity and allocated tariff components (ie AT₂, AT₃ and AT₄ (AT₂₋₄)) for each of the Blackwater, Goonyella, Moura and Newlands systems;
- a revenue cap is applied to the electric access tariff (ie AT₅) for each of the Blackwater and Goonyella systems; and
- directly variable costs (ie the incremental maintenance tariff AT₁ and the electric energy charge) and the QCA levy are not covered by the revenue cap approach and existing pricing approaches apply (QR, sub. no. 1:5).

Coal carrying train services that do not operate exclusively on the CQCR, and all non-coal freight and passenger services across the Queensland network, are excluded the proposed revenue cap approach (QR, sub. no. 1:5).

QR argued that the hybrid revenue cap approach is appropriate because:

- under the existing approach, QR is not compensated for bearing any volume risk;
- coal customers are best placed to manage volume risk – as QR is ‘effectively a passive participant’ in the coal supply chain and only influences the supply of rail access in response to demand that is generated by coal mining companies; and
- there is a ‘significant benefit’ of having similar consistent regulatory frameworks within the coal supply chain to the extent that doing so assists in aligning the parties’ incentives in terms of the way in which they contract for capacity and the circumstances in which they are prepared to invest in additional capacity (QR, sub. no. 1:6-7).

QR argued that system-wide revenue caps provide a relatively simple mechanism that matches the under or over-recovery with allowable revenue, which has been determined on a system-wide basis. In addition, QR noted that a system-wide approach reduces the risk of material price changes for individual end customers by ‘netting off’ variances between clusters, then spreading them over as many customers as is reasonably practicable (QR, sub. no. 1:7).

While QR has proposed to apply a revenue cap to the electric access tariff (ie AT₅) for each of the Blackwater and Goonyella systems, it notes its preference for one AT₅ revenue cap covering both systems. In this regard, QR argues that:

- the electric gross tonne kilometres on the Goonyella and Blackwater systems are not independent;
- the effect of any under-recovery of AT₅ revenue is significantly greater for Blackwater than Goonyella; and
- applying a specific AT₅ revenue cap to Blackwater will increase stranding risk on QR’s electric infrastructure (QR, sub. no. 1:8–9).

On this basis, QR restated its preference for a single revenue cap and, accordingly, proposed to review the charging structure for electric traction during the development of future access undertakings.

Stakeholder Comments

All stakeholders supported, in principle, a move to a hybrid revenue cap but raised concerns about how QR proposed that it be implemented – particularly, QR’s proposal to revise volume forecasts and to retain a volume increment.

While the QRC supported QR’s proposed approach (with the exception of system forecasts and volume increment), it rejected elements of QR’s justification for the change in regulatory arrangements. For example, the QRC rejected QR’s claims that QRNA is a ‘passive participant’ in the supply chain (QRC, sub. no. 2:5). The QRC also questioned QR’s assertion that there are necessarily significant benefits in aligning the form of rail regulation with the arrangements at Dalrymple Bay Coal Terminal (DBCT).

... a significant portion of Central Queensland coal is exported through Hay Point and the Port of Gladstone. While these terminals are not regulated, they are no less relevant than DBCT if an argument is being made that system efficiency demands similar risk allocation or approaches to contracting throughout the supply chain. ... it is important that the regulatory arrangements applied to individual entities be tailored to reflect the particular roles and responsibilities of the relevant entity. A difference in approaches does not necessarily indicate an undesirable inconsistency. (QRC, sub. no. 2:6)

Rather, the QRC supported a move towards a revenue cap ‘primarily as a means of resolving the delays and disputes which arise from QRNA’s reluctance to accept the level of volume risk inherent in the price cap arrangements’ (QRC, sub. no. 2:4). Ensham and RTCA supported the QRC’s views (Ensham, sub. no. 4; RTCA, sub. no. 3).

PN supported the use of a revenue cap in principle, but it did not support QR’s proposal. PN claimed that the proposed arrangements: are unbalanced and are unnecessarily complex (eg retaining long term forecasts, rather using than an annual reset) and serve only to entrench the incumbent (eg take-or-pay) and that QR’s revision of system forecasts have no logical basis (PN, sub. no. 5). PN suggested that some of these complexities might have been avoided if a revenue cap had been adopted at the start of the regulatory period (PN, sub. no. 5).

In addition, PN was concerned about the effectiveness or merits of certain provisions or approaches in the undertaking. For example, PN argued that:

- aligning costs with individual load-points rather than addressing the systems genuinely as systems leads to ‘significant in-built inflexibility and complexity’ that discourages competitors;
- using long-term forecasts to determine volumes, prices and the revenue cap creates complexity which could be reduced if these factors were reviewed annually as demonstrated in the NSW Hunter Valley coal system; and
- when access arrangements for the incumbent do not reflect new (or future) regulatory arrangements, a substantial part of the traffic is effectively ‘locked’ in under different arrangements – entrenching the incumbent (PN, sub. no. 5).

Authority’s Analysis and Draft Decision

The Authority accepts, in principle, QR’s proposal to use a hybrid revenue cap approach for coal-carrying train services in the CQCR. However, it has a number of concerns regarding QR’s proposed implementation of the new arrangements and requires QR amend its proposal to address these issues.

The Authority notes PN’s broader concerns about certain aspects of the undertaking. For the most part, however, these go beyond the intended purpose of the Proposed Schedule F Amendment and cannot be usefully dealt with at this time. For example, notwithstanding the possible merits of PN’s argument that amending the form of regulation ‘mid-stream’ gives rise to additional complexity, the Authority is bound to consider QR’s proposal under the process included in the approved access undertaking.

In relation to the PN’s position on having different contracts arising under different regulatory periods, the Authority notes that it was never the Authority’s intention to reopen existing contractual arrangements as a result of amendments to the access undertaking, or indeed as a result of accepting new or replacement access undertakings. The Authority accepts that this may lead to contracts signed at different times reflecting different regulatory arrangements. However, the Authority notes that QR’s Proposed Schedule F Amendment seeks to limit the extent of these differences by capping the take-or-pay amounts payable for new access agreements (see Section 2.1).

Volume Risk and the Cost of Capital

QR argued that one reason that it has sought to move to a revenue cap is that in the 2006 access undertaking the Authority did not compensate QR for bearing volume risk. As part of its assessment and subsequent approval of the undertaking, the Authority considered in detail whether the form of regulation exposed QR to material volume risk for which it should be compensated. Given the evidence raised by QR and other stakeholders, the Authority considered that, to the extent that QR faced volume risk, that risk was largely uncorrelated with Australian market returns, ie the risk was non-systematic in nature. The Authority, therefore, concluded that volume fluctuations would not have a material impact on QR’s systematic risk, as reflected in the value of its asset beta and therefore the cost of capital.

QRNA’s Role in the Coal Supply Chain

While recognising that QR may have little ability to directly influence the demand for and extraction of Bowen Basin coal, the Authority notes that QR’s activities are a critical element in

the coal supply chain and are an area over which QRNA has control. QRNA has full stewardship for maintaining the network and for managing the development and construction of expansions to system capacity. Without the appropriate management of this infrastructure, the coal supply chain would deteriorate. Any delays in either the maintenance or expansion of the network by QRNA will have real impacts on Queensland's coal-export volumes.

Applying a Revenue Cap to AT₂₋₄ and AT₅ Components of Access Charges

The Authority accepts QR's proposal to apply a revenue cap to QRNA's 'fixed' costs, ie tariff components AT₂₋₄ (excluding AT₁ the incremental maintenance charge) and the electric access tariff AT₅.

The Authority notes that QR intends to exclude from the revenue cap train services that do not operate exclusively on the CQCR (ie there is no revenue cap for train services on the Western System) and all non-coal freight and passenger services across the Queensland network (QR, sub. no. 1:5).

The Authority has no issue with QR limiting the scope of the revenue cap to coal-carrying train services in central Queensland. Nevertheless, the scope of the services included within the revenue cap needs to be carefully defined to ensure that the costs of the services provided match the revenues of the services provided.

In the past, the Authority has considered QR's CQCR reference tariffs on the basis of the costs of a stand-alone coal network and has set aside the costs and the revenues associated with non-coal traffics. This has not always proven to be straight forward. For example, in its December 2005 decision on QR's draft access undertaking, the Authority required QR to amend both its proposed asset base and maintenance costs to remove assets and costs that were not required for a stand alone coal network.

These concerns are potentially more significant in moving from a price cap to a revenue cap where:

- the below rail network is vertically integrated with a train operator; and
- there is significant potential for providing access to services that vary from the reference train or on terms and conditions that vary from those in the Standard Access Agreement (SAA).

Under a price cap, a primary concern of the Authority is that QR does not offer itself access on terms that are preferential to the terms on which it offers to another party. The Authority need not concern itself so much about the extent to which QR negotiates contracts on terms that diverge from those as specified in a reference tariff or in the SAA as they tend to be commercial risks or rewards that are agreeable to QR or, failing agreement, are subject to dispute resolution.

This is not the case under a revenue cap. For example, access holders who have performed to contract volumes could be asked to make a further contribution because QR has not achieved its revenue targets because of the underperformance of other access holders. In this way, an access holder is asked to underwrite the commercial arrangements of a rival access holder. The Authority's particular concern in this case is where that rival is part of a vertically integrated organisation. For example, one could envisage a circumstance where:

- QRNA might agree to an access agreement with QRNational on softer commercial terms than exist in the SAA; or

- QRNational could refuse to pay certain monies required of it under an access agreement and QRNA could choose not to pursue this matter.

In these circumstances, it is unlikely that QRNA would suffer a commercial disadvantage as any revenue shortfall would be underwritten by other access holders or, depending on the terms of the haulage agreement, by other end customers.

The Authority notes that stakeholders raised a similar concern in the context of the Authority's consideration of QR's proposed take-or-pay arrangements (see Section 2.1). However, this matter is a concern of a more general nature in relation to the collection of all monies that comprise the revenue cap, including AT₂₋₄ revenues and relinquishment fees.

While the Authority has no reason to believe that there are any access agreements that would currently give effect to the Authority's concern, there is potential for this to become an issue in the future.

In the case of the revenue cap at DBCT, this matter was addressed by apportioning the annual revenue requirement between reference and non-reference tonnes and applying the revenue cap to the reference tonnes, which were defined by the terms of the SAA. Moreover, the risk of an insolvent access holder is held by the terminal operator for the term of an undertaking. In that case, the design and operation of the revenue cap was not further complicated by incentives resulting from vertical integration.

The Authority considers that the QR revenue cap should apply to *all* coal-carrying train services that operate in the CQCR and, as proposed, should not apply to the variable elements of the access charge.

The Authority notes that, by definition, the revenue cap is developed on the basis of AT₂₋₄ and AT₅ component of access charges for coal-carrying train services operating in the CQCR for each coal system – which could arguably also exclude revenue from those coal-carrying train services operating on the CQCR that have access charges that are constructed on a different basis. While perhaps unintended, this is clearly not appropriate and is inconsistent with the principle of a framework that covers all coal-carrying train services in the CQCR.

On that basis, the Authority requires that, in moving to a revenue cap, QRNA must construct access charges such that any revenue from those train services is included in the revenue cap, and adjusted according to the revenue cap adjustment mechanism (ie, using the AT₂₋₄ and AT₅ tariff components).

3.5 Access Charges in the Central Queensland Coal Region

3.5.1 Unless prior written approval from the QCA is received, QR must calculate all Access Charges used for Train Services in the Central Queensland Coal Region by reference to the same components as Reference Train Services (AT1, AT2, AT3, AT4, AT5, the QCA Levy, and EC if appropriate), even if the Train Service does not constitute a Reference Train Service.

The Authority accepts that its proposal will limit the structure of access charges but notes that, to date, existing contracts and access charges are based on this approach. An alternative approach that might provide greater contracting flexibility would require a redefinition of the revenue cap such that it applies to train services more broadly (to specifically include those train services with access charges that do not use the AT₂₋₄ and AT₅ tariff components) and to include a (more complex) revenue adjustment mechanism which appropriately adjusts the tariff components as well as the access charge for other train services within the revenue cap.

Given the increased complexity of seeking to adopt such an approach, the Authority does not propose to pursue this approach further itself – but would consider a proposal that is consistent

with general objective that the revenue cap apply to all coal-carrying train services that operate on the CQCR.

Draft Decision 1

The Authority accepts that the revenue cap apply only to the fixed elements of the access charge of coal-carrying services in the central Queensland coal region.

The Authority requires that QR construct access charges such that any revenue from those train services is included in the revenue cap, and adjusted according to the revenue cap adjustment mechanism (ie. using the AT₂₋₄ and AT₅ tariff components).

1.2 System Allowable Revenue

QR's proposed revenue cap approach provides for QR to retain its System Allowable Revenue (SAR) – with any over- or under-recovery of SAR (adjusted for a volume increment) being subsequently returned or recouped through a revenue cap adjustment mechanism (see Section 4.2).

QR Proposal

QR proposed that the SAR for each individual coal system be:

- the total revenue from AT₂₋₄ arising from all access agreements in relation to that infrastructure that QR is entitled to earn over the relevant year; and
- for each of the Blackwater System and the Goonyella System, the total revenue from the AT₅ component of access charges arising from all access agreements in relation to that infrastructure that QR is entitled to earn over the relevant year.

In doing so, QR did not provide any adjustment to the SAR to reflect tonnage shortfalls caused by QR on the basis that:

- to do so would be inconsistent with the principle of a revenue cap – that *all* of QRNA's allowable revenue should be recovered from access holders;
- QR is unaware of similar arrangements in other revenue cap arrangements; and
- the SAAs already provide contractual remedies for an access holder for loss or damage arising either from a wilful default of the access agreement, or any deliberate or negligent act by QR (QR, sub. no. 1:25).

Stakeholder Comments

The QRC argued that the SAR should, at a minimum, be reduced to reflect the effects of negligence by QRNA or a breach by QRNA of its obligations under any access agreement or under the undertaking.

In addition, the QRC also argued that QR should be exposed to 'a low level of volume risk / incentive' such that a +/-2 percent variation from SAR should be excluded from the revenue adjustment mechanism (QRC, sub. no. 2:12).

Authority's Analysis and Draft Decision

While the Authority accepts that, in moving to a hybrid revenue cap, QR should be not be materially exposed to volume risk, it does not accept QR's claim that it should recover its allowable revenue in all circumstances.

The Authority agrees with the QRC's suggestion that QRNA's SAR should be reduced to the extent that actual revenue has been reduced as a result of the effects of negligence by QRNA or a breach by QRNA of its obligations under the access agreement or under the access undertaking.

Accordingly, the Authority requires that the definition of SAR included in the access undertaking also include an adjustment to the extent that QRNA fails to provide access due to its own default or negligence but at the same time avoids double counting relating to contractual remedies.

"System Allowable Revenue" means:

(i) for AT2-4 in relation to an Individual Coal System Infrastructure the total revenue from AT2-4 arising from all Access Agreements in relation to that Individual Coal System Infrastructure that QR is entitled to earn over the relevant Year, as specified in Clauses 5.4, 6.4, 7.5 and 8.5 of Part B (as amended from time to time); and

(ii) for the AT5 component of Access Charges for either the Blackwater System or the Goonyella System the total revenue from the AT5 component of Access Charges arising from all Access Agreements in relation to the Individual Coal System Infrastructure that QR is entitled to earn over the relevant Year, as specified in Clauses 5.4 and 6.4 of Part B (as amended from time to time); less

(iii) for:

• paragraph (i) of this definition any revenue from AT2-4; or

• paragraph (ii) of this definition any revenue from the AT5 component of Access Charges,

that the QCA reasonably determines that QR would have otherwise been entitled to earn under all Access Agreements in relation to that Individual Coal System Infrastructure during the relevant Year, but which it was not entitled to earn due to its own breach of an Access Agreement or the Undertaking, or its own negligence.

While this drafting is different to the drafting proposed by the QRC, the Authority considers that it achieves the same outcome (ie reducing SAR for QRNA's default or negligence) while reducing the extent of amendments required to QR's proposal.

The Authority will assess whether any adjustment to the SAR (as specified in cl. 5.4, 6.4, 7.5, and 8.5 of the access undertaking) is required as part of its assessment of proposed variations to reference tariffs in response to revenue adjustments (Schedule F, Part A, cl. 3.3.7). To avoid any doubt, and in the interests of clarity, the Authority requires QR to specifically provide for the Authority to adjust any proposed variation to reference tariffs in response to a revenue adjustment on the basis of its assessment of whether QR has failed to provide access due to its own default or negligence (see Draft Decision 5).

Draft Decision 2

The Authority does not accept QR's proposed definition of System Allowable Revenue.

The Authority requires QR to adjust the System Allowable Revenue to the extent that QR fails to provide access due to its own default or negligence.

The Authority requires that QR specifically provide for the Authority to adjust any proposed variation to reference tariffs in response to a revenue adjustment on the basis of its assessment of whether QR has failed to provide access due to its default or negligence (see also Draft Decision 7).

1.3 Proposed Revisions to System Forecasts and System Allowable Revenues

QR Proposal

QR has proposed a one off variation to the system forecasts and allowable system revenues to:

- manage the transition to a revenue cap mid-way through the regulatory period;
- acknowledge the transfer of risk from QR to customers; and
- minimise the cash flow effects associated future revenue cap adjustments (QR, sub. no. 1:9).

QR argued that revising the system forecasts and SAR is a necessary response to changing the form of regulation in order to minimise any subsequent revenue adjustment to SAR.

Current and expected deviations in actual volumes compared to the System Forecasts ... will certainly result in a revenue cap adjustment being required. Whilst this deviation is an unavoidable consequence of the change, the expected value of the adjustment should be minimised. (QR sub. no. 1:10)

In particular, on the basis of its year to date results and latest forecasts, QR expects that actual demand will vary from the approved forecasts included in QR's access undertaking – with the likely consequence that significant revenue cap adjustments would be required across all systems (Table 1).

Table 1: Likely revenue Cap Adjustments (existing volume forecast) (\$ million)

	<i>AT₂₋₄</i>	<i>AT₅</i>
2006-07	20 (under-recovery) All systems: under-recoveries	5 (under-recovery)
2007-08	10 (over-recovery) Goonyella system: 10 (under-recovery) Remaining systems: 20 (over-recovery)	5 (under-recovery)
2008-09	35 (over-recovery)	5 (under-recovery)

QR, sub. no. 1: 11

QR indicated that it has sought to minimise the expected size of any revenue cap adjustment while remaining revenue neutral (in present value terms).

... the intent of QR's proposal is to 're-distribute' this revenue across the remaining years of the regulatory period in a manner that reflects the expected volume outcomes. Overall, this proposal will result in QR remaining revenue neutral (in present value terms) for the duration of the regulatory period. (QR sub. no. 1:10)

While QR did not quantify the expected size of the revenue cap adjustments with the revised forecasts in its submission, it nonetheless noted that the proposal is expected to ‘substantially reduce’ the variation in the revenue cap adjustment, and also bring forward a revenue cap adjustment from the subsequent regulatory period (QR, sub. no. 1:11).

In addition, QR suggested that revising the forecasts in this way is consistent with revisions made in 2005-06.

QR determined the system forecasts and SAR included in its proposal using the modelling parameters and assumptions used to determine the reference tariffs for its approved access undertaking. In doing so, QR noted that it had sought to hold the present value of QRNA’s revenue stream in each system constant throughout the remainder of the regulatory period, which also would maintain tariffs at their current rates. QR stated that its adjustments to SAR are based on revised forecast tonnes which are ‘broadly consistent’ with QR’s Corporate Plan forecasts and independent forecasts prepared during October 2006 for the Coal Master Planning process. In addition, QR noted that the revised volumes are ‘well below’ the relevant system capacities as set out in the Coal Master Plan (QR sub. no. 1:12).

Stakeholder Comments

Stakeholders did not support QR’s proposal to re-profile the volume forecasts for the remainder of the period (QRC, sub. no. 2; RTCA, sub. no. 3; Ensham, sub. no. 4; PN, sub. no. 5). In particular, the QRC noted that revenue cap adjustments, and the associated cashflow effects, are an ‘inherent feature’ of adopting a revenue cap approach – and that there is no case for treating 2006-07 differently to other years by updating the forecasts during the regulatory period.

The QRC was also concerned that QR’s proposed forecasts have not been established to reflect the expected future throughput:

... adopting forecasts which have been calculated to produce a pre-determined result is a departure from the proper process of establishing reference tariffs and will create winners and losers compared to the likely outcomes of the existing forecasts. (QRC, sub. no. 2:8)

PN supported the QRC’s view that there was no obvious logic to QR’s proposal.

The QR proposal looks to be a manufactured result designed to achieve the same end result but through avoiding imposing a take-or-pay component early in the life of the revenue cap. PN is not privy to the forecast data on which these numbers are based and so is not in a position to comment on whether the bounteous final year is founded on sound predictions, but the impact of shifting the burden on to that final year will be to magnify any take-or-pay amounts that would arise if the forecast is in fact ill-founded. (PN, sub. no. 5:6)

In addition, PN argued that using long term forecasts to determine volumes, prices and SAR introduces unnecessary complexity – and that adopting an annual review of volumes, prices and revenue cap would simplify the scope of the task and reduce uncertainty.

Many of the concerns raised, and much of the complexity of the proposal, stem from QR’s persistence with using long term forecasts for the determination of volumes, prices and the revenue cap. ... The living example of the Hunter Valley coal system demonstrates that an annual calculation of prices to deliver a revenue cap is not only perfectly workable, it can be achieved with substantially less debate and complexity than has already arisen under the QR proposal. (PN, sub. no. 5:4)

Authority’s Analysis and Draft Decision

The Authority notes that QR anticipates that significant revenue cap adjustments may be required for the remainder of the regulatory period, given QR’s current information and expectations. QR has sought to minimise this potential impact on relevant parties in light of

this, by revising its forecasts and, further, has sought to do it in a way that does not alter the net present value of its revenue stream over the regulatory period.

However, the Authority notes that stakeholders, who are ultimately affected by revenue cap adjustments, do not support QR's proposal. Indeed, as an industry, members of the QRC strongly objected to QR's proposal to revise system forecasts. On this matter, the Authority agrees with the QRC that QR's proposed revenue adjustment mechanism is an 'inherent' feature of a revenue cap, and should be adequate for dealing with variations between forecast demand and actual throughput. The Authority also agrees with the QRC that QR's proposed revisions will create a new set of 'winners and losers' between not only individual mines, but also between QRNational, the mines and potential third party operators.

Moreover, on the information before it, it is not clear why it is necessary for QRNA to revise forecasts and SAR in this way – since the effect, in particular its effect on QRNA, is revenue neutral (in net present value terms) over the regulatory period.

Given this, and stakeholders' clear objections to QR's proposal and their preference to maintain current approved forecast volumes and SAR, the Authority requires QR to retain the current approved forecast volumes (Table 4).

Table 4: QR's Current System Forecasts (GTKs '000)

<i>System</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>
Goonyella	34,232,302	37,066,523	37,465,285
Blackwater	27,622,255	28,621,513	29,788,739
Newlands	3,674,026	3,781,598	3,781,598
Moura	3,431,372	3,414,578	4,069,312
Total CQCR	68,959,955	72,821,212	75,041,934

QR, sub. no. 1:12

The Authority requires QR to include current SAR in the access undertaking.

The Authority notes that it approved QR's annual revenue requirements as part of its June 2006 decision (see tables 1.3 and 1.4 of that decision) and requires QR to use these to determine the SAR – ie include the SAR that was implicit in the reference tariffs that the Authority approved in its June 2006 final approval.

Draft Decision 3

The Authority does not accept QR's proposal to revise system forecasts and system allowable revenues and instead requires that QR maintain current approved forecasts and current system allowable revenues.

The Authority requires that QR amend the tables in clauses 5.4, 6.4, 7.5 and 8.5 of Part B of Schedule F to reflect current system forecasts and system allowable revenues.

2. TAKE-OR-PAY ARRANGEMENTS AND RELINQUISHMENT FEES

QR has proposed detailed processes to support the operation of its proposed new regulatory framework, including arrangements for take-or-pay and relinquishment fees. Under these arrangements, QR has retained its existing take-or-pay provisions, but will impose a cap on the take-or-pay amounts collected from agreements executed under the 2006 access undertaking. QR has maintained existing arrangements for relinquishment fees for access agreements signed prior to the 2006 access undertaking.

The Authority accepts, in principle, QR's proposed take-or-pay arrangements, but requires QR to clarify how the take-or-pay arrangements will be applied in practice. In particular, the Authority has sought to ensure that QR always consider revenue amounts that QRNA is entitled to be paid, regardless of whether QRNA in fact collects that amount. The Authority also proposes that renewed or transferred access agreements be subject to the same take-or-pay arrangements as other access agreements executed under the 2006 access undertaking.

The Authority accepts QR's proposal for relinquishment fees for access agreements signed prior to 2006 access undertaking. The Authority will consider arrangements for relinquishment fees for access agreements signed under the 2006 access undertaking separately, but in parallel, via a draft amending undertaking process.

2.1 Take-or-pay Arrangements

Take-or-pay mechanisms can reduce revenue uncertainty related to demand falling below contracted levels by imposing penalties on above-rail operators for not realising contracted train services. That is, when an above-rail operator does not require the entire amount of its contracted capacity (train services), it is contractually obliged to make some payment in lieu of not using this capacity.

These arrangements mitigate any revenue reduction which may arise from demand falling below contracted levels, and encourage above-rail operators to enter into contracts which do not overstate demand expectations.

QR Proposal

QR has proposed that existing take-or-pay provisions continue for train services operating in the CQCR, with the exception that a cap be imposed on access agreements executed after 30 June 2006 (UT2 access agreements) to limit those above-rail operators' take-or-pay exposure given its revenue cap arrangements (in order to avoid over-recovery of allowable system revenues).

Under these arrangements, take-or-pay amounts for UT2 access agreements would be payable when the total revenue for each system excluding take-or-pay amounts under UT2 access agreements is less than SAR. In those circumstances, QR will calculate:

- the amount of the under-recovery – inclusive of actual tariff revenue, aggregate take-or-pay revenue arising from grandfathered access agreements and access agreements made under QR's 2001 access undertaking arrangements, relinquishment fees and transfer fees (less permitted reductions); and
- aggregate take-or-pay revenue arising from UT2 access agreements.

If the aggregate take-or-pay revenue arising from UT2 access agreements is greater than the calculated under-recovery, then the amount of take-or-pay under UT2 access agreements each

access holder will pay is reduced in proportion to the amount of take-or-pay that would have arisen under the UT2 access agreement.

Stakeholder Comments

The QRC supported QR's proposal relating to take-or-pay, including to strengthen take-or-pay arrangements for UT2 access agreements.

... take or pay arrangements should create strong incentives for an Access Seeker (and ultimately a mine) to contract only for capacity for which the Access Seeker / mine has genuine sustainable demand. This is why the QRC supports the substantial strengthening of take or pay arrangements and relinquishment fees under UT2, relative to the take or pay and relinquishment fees which applied to Access Agreements signed during UT1. ... The QRC supports QRNA's proposals in regard to take or pay, including the approach proposed by QRNA for UT2 Access Agreements, (QRC, sub. no. 2:9)

The QRC also supported QR's proposal to cap take-or-pay amounts for UT2 access agreements. Ensham and the RTCA supported the QRC's view (RTCA, sub. no. 3; Ensham, sub. no. 4).

In contrast, PN argued that it was unclear that QR's proposal 'necessarily adds significant value'. In particular, PN questions QR's concerns regarding overcontracting:

QR appears to be very concerned that there would be opportunities to "game the system" through various means eg by ambitious volume forecasts, and the take-or-pay arrangements are constructed to avoid the possibility of such games being played. ... QR doesn't provide any meaningful examples of how such gaming would occur, or if it occurs, how it would be effective. Without such examples, PN finds it difficult to understand the impact of the concern. (PN, sub. no. 5:6)

PN also suggested that providing for different take-or-pay arrangements for UT1 and UT2 access agreements (ie strengthening take-or-pay for UT2 access agreements) does little more than protect QRNational's existing contracts – in effect providing for QR to treat QRNational differently to new access seekers.

... the take-or-pay provisions for each system will vary dependant on whether the contract was under the previous Undertaking (UT1) or the new Undertaking (UT2). This places a potential competitor in the position that it is necessarily subject to different access arrangements compared to the incumbent, and therefore is not something that PN could support. ... To answer this proposition by saying that it is not QR that is treated differently but UT1 access contract holders is not a valid answer as QR is the only relevant holder of a UT1 contract. (PN, sub. no. 5:6)

PN argued that, by doing this, QRNA disadvantages PN in negotiations to take on existing volumes that are currently assigned to an operator that negotiated its position under previous arrangements (ie. QRNational).

PN also argued that it was unclear how the arrangements would work in practice – and suggested that worked examples of the operation of the take-or-pay mechanism would provide some insights into this.

It is recognised that the QRC and QR have been in discussion over some period regarding this matter and that those parties are clear in their minds as to the meaning of the proposal. For PN, who has not been directly involved in those discussions, the precise meaning and intended operation is far from clear from the drafting. (PN, sub. no. 5:7)

The QRC was also concerned that the proposed drafting is 'ambiguous' in relation to whether the amount of take-or-pay to be taken into account is the amount actually earned and collected by QRNA or the amount that QRNA is entitled to earn, regardless of whether it is actually collected:

... the appropriate amount to be taken into account for the purposes of these clauses in Schedule F is the amount that QRNA is entitled to earn. If QRNA fails to recover any take or pay revenue to which

it is entitled (either by choice or due to credit risk of an Access Holder), other users of the relevant system should not have to meet the under recovery that could result. (QRC, sub. no. 2:10)

The QRC argued that, in determining the take-or-pay amount that QRNA is entitled to earn, QRNA should bear any risk of contracting on terms other than those in the SAAs in force at the time (QRC, sub. no. 2:10).

On that basis, the QRC provided additional drafting to clarify that the take-or-pay amounts that should be taken into account is the amount that QRNA is entitled to earn – whether it collects that amount or not. Ensham and the RTCA supported the QRC’s view (RTCA, sub. no. 3; Ensham, sub. no. 4).

Authority’s Analysis and Draft Decision

The Authority accepts, in principle, QR’s proposed take-or-pay arrangements and notes that, with the exception of PN, stakeholders agreed that stronger take-or-pay arrangements provide incentives for access holders and end customers to contract accurately.

The Authority also accepts PN’s view that stronger take-or-pay arrangements for new access agreements may disadvantage new access seekers compared to existing contracts.

To limit this disadvantage, the Authority considers that the stronger take-or-pay arrangements should not apply where access rights have been transferred from a pre-existing agreement. In particular, the Authority considers that, where capacity under an existing contract is transferred (under clause 7.4.4 of the access undertaking), the take-or-pay of the replacement (transferred) contract should be based on the original take-or-pay arrangements, but only for the term of the original contract. This reduces any advantage the incumbent might have over a new entrant relating to end user customers that might seek to transfer capacity rights from their existing train operator to another operator.

However, the stronger take-or-pay arrangements should apply for new contracts. In these circumstances, the extent of any differential treatment between UT1 and UT2 access holders will be diminished over time as existing contracts expire and the replacement contracts take up the new arrangements. In this vein, the Authority notes that QR’s proposal does not specifically deal with take-or-pay arrangements for UT1 access agreements that are subsequently renewed under QR’s current access undertaking. The Authority considers that renewed access agreements should be on the same footing as new access agreements.

Accordingly, the Authority requires QR to amend its take-or-pay arrangements to specifically account for renewed agreements — and, in particular, provide that renewed agreements be subject to stronger take-or-pay arrangements. The Authority also requires QR to ensure that transferred capacity is *not* treated as a new contract and, therefore, does not take up the stronger take-or-pay arrangements.

- 2.2.2 Subject to any amendment pursuant to Clause 3, for Train Services for which Access Agreements are executed or renewed on or after the Commencing Date (other than New Access Agreements entered as part of transferring Access Rights from Access Agreements in place on the day immediately prior to the Commencing Date pursuant to clause 7.4.4(f) of the Undertaking), the Take or Pay arrangements will be as specified in Subclause 2.2.3. Subject to any amendment pursuant to Clause 3, for Train Services included in Access Agreements in place on the day immediately prior to the Commencing Date (and not subsequently renewed after the Commencing Date) or New Access Agreements entered as part of transferring Access Rights from such Access Agreements pursuant to clause 7.4.4(f) of the Undertaking, the Take or Pay arrangements will be as specified in Subclause 2.2.5.

In addition, the Authority accepts the QRC’s concern that there is some uncertainty about whether, in practice, implementing the proposed arrangements could shift liabilities from

QRNational to other users – in particular, if QRNA does not recover the entire take-or-pay revenue it is entitled to recover from QRNational. The Authority concurs with the QRC that the take-or-pay amount should be the amount which QRNA would be entitled to be paid from all access agreements if QR had contracted on the terms of the relevant SAA regardless of whether QRNA in fact collects this amount. In particular, QRNA should bear the risk of any decision it makes to contract on terms other than those included in the SAAs. Moreover, access holders should not be asked to underwrite more liberal take-or-pay arrangements included in a rival's access agreement.

Accordingly, the Authority requires QR always to consider the amount of take-or-pay *which QRNA would be entitled to be paid from all access agreements if QR had contracted on the terms of the relevant SAA*, regardless of whether QRNA in fact collects this amount, in making take-or-pay calculations and determining take-or-pay amounts. In coming to this conclusion, the Authority notes that QR's proposed definition of Total Actual Revenue already appears to take this into account, but that QR's proposed provisions to calculate take-or-pay (in Schedule F, Part b, cl. 2.2 and in the SAAs) currently do not.

Consequently, in the interest of clarity, the Authority proposes that QR amend the undertaking and SAAs to specify the revenue QR is entitled to earn – and, for this purpose, the Authority considers that QR should be deemed to have contracted on the terms of the relevant SAA that applied on the date of execution or renewal of an access agreement.

2.2.6 Notwithstanding Subclause 2.2.3, where the Total Actual Revenue for AT2-4 for an Individual Coal System Infrastructure less the aggregate amount of Take or Pay that QR would be entitled to earn from all Access Agreements in relation to that Individual Coal System Infrastructure executed or renewed on or after the Commencing Date (other than New Access Agreements entered as part of transferring Access Rights from Access Agreements in place on the day immediately prior to the Commencing Date pursuant to clause 7.4.4(f) of the Undertaking) ("Total Revenue") is:

- (a) greater than or equal to the System Allowable Revenue for AT2-4 in relation to that Individual Coal System Infrastructure, Take or Pay shall not be payable for that Year under Access Agreements in relation to that Individual Coal System Infrastructure executed or renewed on or after the Commencing Date (other than New Access Agreements entered as part of transferring Access Rights from Access Agreements in place on the day immediately prior to the Commencing Date pursuant to clause 7.4.4(f) of the Undertaking) ("UT2 Agreements");
- (b) less than the System Allowable Revenue for AT2-4 in relation to that Individual Coal System Infrastructure:
 - (i) QR will calculate the aggregate amount of Take or Pay that QR would be entitled to earn from all UT2 Agreements ("Total Actual Take or Pay"); and
 - (ii) if the Total Actual Take or Pay exceeds the amount by which the System Allowable Revenue for AT2-4 exceeds the Total Revenue for that Individual Coal System Infrastructure ("Maximum Take or Pay Amount"), then:
 - (A) QR will calculate for each relevant Access Holder, the proportion that the Access Holder's Take or Pay amount bears to the Total Actual Take or Pay ("Proportion"); and
 - (B) each relevant Access Holder's Take or Pay amount will be reduced to equal that Access Holder's Proportion of the Maximum Take or Pay Amount.

For the avoidance of doubt, what QR was entitled to earn for the purposes of this clause 2.2.6 is to be calculated on the basis that QR has contracted on the terms of the relevant Standard Access Agreement that applied on the date of execution or renewal of an Access Agreement (or in the case of New Access Agreements entered as part of transferring Access Rights from Access Agreements in place on the day immediately prior to the Commencing Date pursuant

to clause 7.4.4(f) of the Undertaking which have not been renewed subsequent to the Commencing Date, the date of execution of the original Access Agreement from which the Access Rights are being transferred).

For completeness, the Authority also requires QR to include any AT₂₋₄ and AT₅ revenue from access agreements that QR earned but failed, or was unable to collect during the relevant year (see Section 1.1).

“Total Actual Revenue” means:

(i) for AT₂₋₄ in relation to an Individual Coal System Infrastructure, the total revenue from AT₂₋₄ (including the amount of any Take or Pay amounts, Relinquishment Fees and transfer fees under Subclause 7.4.4 of the Undertaking which QR is entitled to be paid but, for the avoidance of doubt, less the amount of any reductions of those amounts in accordance with the Undertaking) arising from all Access Agreements in relation to that Individual Coal System Infrastructure that QR has actually earned over the relevant Year; and

(ii) for the AT₅ component of Access Charges for each of the Blackwater System or the Goonyella System, the total revenue from the AT₅ component of Access Charges arising from all Access Agreements in relation to that Individual Coal System Infrastructure that QR has actually earned over the relevant Year; and

In calculating the Take or Pay and Relinquishment Fee amounts which QR is entitled to be paid for the purposes of determining the AT₂₋₄ portion of Total Actual Revenue, QR will be deemed to have contracted on the terms of the relevant Standard Access Agreement that applied on the date of execution or renewal of an Access Agreement. In addition total revenue for both AT₂₋₄ and AT₅ will include all revenue of the relevant components arising from Access Agreements that QR earned but did not collect during the relevant Year.

The Authority notes that these arrangements are broadly consistent with the QRC’s suggested arrangements.

Draft Decision 4

The Authority does not accept QR’s proposed take-or-pay arrangements.

The Authority requires QR to amend its proposed take-or-pay arrangements (in Schedule F and in the Standard Access Agreements) such that:

- **new or renewed contracts are subject to the take-or-pay arrangements included in the access undertaking;**
- **where access rights are transferred, the take-or-pay arrangements in the original contract will be transferred to the replacement contract for the term of the original contract; and**
- **QR must always consider the amount of take-or-pay which QRNA is entitled to be paid from all access agreements in making take-or-pay calculations and determining take-or-pay amounts.**

The Authority requires QR to amend its definition of total actual revenue such that:

- **QR will be deemed to have contracted on the terms of its Standard Access Agreement; and**
- **QR is required to include any AT₂₋₄ and AT₅ revenue from access agreements that QR earned but failed, or was unable to collect during the relevant year.**

2.2 Relinquishment Fee

The access undertaking provides for an access holder to negotiate a reduction in its capacity entitlement with QR upon payment of a relinquishment fee (cl. 7.4.3).

The relinquishment fee is defined in the access undertaking – with the amount payable depending primarily on when the access agreement was made (ie under or prior to the existing access undertaking). The relinquishment fee can then be reduced to the extent that the relinquished access rights are replaced by new access agreements (cl. 7.4.3).

QR Proposal

QR proposes to maintain existing arrangements for relinquishment fees for access agreements signed prior to 30 June 2006 (ie grandfathered access agreements and access agreements made under QR's 2001 access undertaking). Under these arrangements, the relinquishment fee payable is the take-or-pay amount that would have been payable for the following two year period if the access agreement remained on foot but the access holder did not operate the relevant train services.

While QR and the QRC considered separate arrangements for access agreements made under the 2006 access undertaking, they were not included as they were unlikely to be within the scope of the Proposed Schedule F Amendment.

On 18 April 2007 QR submitted a draft amending access undertaking for the Authority's consideration relating to relinquishment fees amounts for access agreements executed on or after 1 July 2006 under s142 of the QCA Act.

Authority's Analysis and Draft Decision

The Authority accepts QR's proposal to maintain existing arrangements for relinquishment fees for access agreements signed prior to 30 June 2006.

That said, the Authority has included in its proposed drafting a number of consequential changes relating to relinquishment fees. In particular, the Authority considers that where capacity under an existing contract is transferred, then the relinquishment fees in the replacement (transferred) contract should be based on the original arrangements, but only for the term of the original contract.

The Authority notes that amendments to the relinquishment fee arrangements for access agreements executed under the 2006 access undertaking are beyond the scope of the Proposed Schedule F Amendment. It therefore proposes to consider the submissions received on this matter through a separate draft amending access undertaking process.

3. REVIEW EVENT

In the past, reference tariffs were reviewed when volumes moved outside a pre-determined range (ie a review event). However, in the context of a revenue cap, a volume-based review event is no longer required.

In these circumstances, QR has proposed to define a review event as those circumstances where QR considers there is a need to vary a reference tariff.

The Authority proposes to require QR to redefine its definition of a review event such that QR and the Authority must agree that a review event has occurred. In doing so, the Authority has sought to provide an arrangement that is more flexible than an amending undertaking process, but that limits minor or unnecessary changes.

3.1 Review Event

QR's 2001 access undertaking and its 2005 draft access undertaking both included a review event defined in terms of a variation in coal volumes beyond a predetermined trigger level. Given the uncertainty surrounding the treatment of volume risk, the 2006 access undertaking provided for the definition of a review event to be included as part of the Proposed Schedule F Amendment.

QR Proposal

QR has included a new definition of a review event:

... the circumstances which QR considers to give rise to a need to vary a Reference Tariff, but only where QR has given written notice to the QCA of QR's intention to propose a variation to that Reference Tariff ...

QR has proposed to maintain the existing procedures to be followed when a review event occurs. Under these arrangements:

- QR must submit a variation of the relevant reference tariff within 60 days of a review event occurring; and
- the Authority may approve the proposed variation, if it is satisfied that the review event has occurred, and the variation is:
 - consistent with the change in the cost resulting from the review event; and
 - reflects the impact of the review event on the financial position of QR's below-rail services (Schedule F, Part A, cl. 3.3.6).

Stakeholder Comments

Stakeholders did not support QR's proposed definition of the review event. PN argued that including a review event to reopen the revenue cap was 'intriguing' and has the element of 'having it both ways' (PN, sub. no. 5:8).

The QRC noted that the proposed definition does not provide access holders or coal producers with the opportunity to seek to vary the reference tariffs – and that, in principle, access holders and coal producers need mechanisms under which they can request that the Authority review such matters (QRC, sub. no. 2:11). Ensham and the RTCA supported the QRC's view (RTCA, sub. no. 3; Ensham, sub. no. 4).

Authority's Analysis and Draft Decision

The Authority notes that QR was required to include a definition of review event under the process described in the approved access undertaking (Schedule F Part B cl. 3.3). In the past, the review event was reasonably well defined and was clearly focused on managing QR's volume risk in the context of a price cap.

In contrast, QR's proposed definition of the review event is neither well defined nor included with any clear objective in mind.

Indeed, it is questionable whether the review event as defined in Proposed Schedule F Amendment actually serves a useful purpose as QR can always use the voluntary amending undertaking provisions contained in the QCA Act to amend the undertaking. On this matter QR notes that:

QR and the QRC considered that ... the existing process (i.e. to fix forecasts for the regulatory period and, if necessary, for QR to prepare a draft amending undertaking pursuant to Section 142 of the QCA Act) should be sufficiently adequate to deal with volume variations under a revenue cap form of regulation. (QR, sub. no. 1:21)

Nevertheless, the Authority is open to retaining an arrangement that is more flexible than an amending undertaking, to provide QRNA with the opportunity to seek to review reference tariffs in response to significant changes. The Authority does not consider it to be in the interests of access seekers or the public interest that the review event mechanism also include minor or unnecessary changes. On that basis, the Authority considers that QR should seek to initiate a review event only when circumstances would result in QR obtaining or suffering a materially significant financial advantage or disadvantage if the reference tariffs continued to apply unchanged. It is also noted that this test is consistent with QR's proposal that, when assessing a proposed tariff variation, the Authority must consider the impact of the relevant review event on QRNA's financial position (Schedule F, Part A, cl. 3.3.6(c)(ii)).

On this basis, the Authority requires that QR amend its proposed definition of a review event such that QR and the Authority must agree that the event has occurred.

"Review Event" means a material change in circumstances which QR and the QCA agree may give rise to a need to vary a Reference Tariff, but only where QR has given written notice to the QCA of QR's intention to propose a variation to that Reference Tariff under Clause 3.3 of Part A;

The Authority considers that this is consistent with QR's proposal that the Authority must be satisfied that a review event has occurred for it to approve a proposed variation of the tariff component in response to a review event (Schedule F, Part A, cl. 3.3.6(c)(i)).

In this regard, and consistent with the QRC's view, the Authority will monitor the use of the review event over the remaining regulatory period with a view to better informing itself on this matter for the next review of QR's undertaking.

Draft Decision 5

The Authority requires that QR amend its proposed definition of a review event such that there is a material change in circumstances that QR and the Authority agree gives rise to a need to vary a reference tariff.

4. CONSEQUENTIAL AMENDMENTS

QR's Proposed Schedule F Amendment provides for amendments to QR's approved access undertaking which are required as a consequence of the amendments discussed above. These include:

- *a volume-related 'increment' that QR could seek to retain when the actual tonnage exceeds forecast tonnage and there is an over-recovery (section 4.1); and*
- *a revenue adjustment mechanism which provides for any over- or under-recovery of system allowable revenue to be subsequently returned or recouped, through adjustments to the relevant reference tariff components (section 4.2).*

The Authority accepts QR's volume increment, subject to it being applied to a system allowable revenue that has been adjusted to reflect the effects of QRNA's default or negligence, on the basis that this provides QR with an incentive to improve performance while moving the majority of volume risk to the above-rail operators and their customers and that alternative arrangements have not yet been developed.

The Authority accepts, in principle, QR's proposed revenue cap adjustment mechanism, but requires QR to clarify how the take-or-pay arrangements will be applied in practice. In particular, in the interests of ensuring the transparency and accountability of any revenue adjustments, the Authority has proposed that:

- *QR be required to provide a 'responsibility statement' with its claims supporting any revenue cap adjustment; and*
- *the Authority publish details of QR's proposed variation (subject to confidentiality) to provide stakeholders with an opportunity to comment on the proposed variations.*

In addition, to reflect Draft Decision 2, the Authority has required QR to specifically provide for the Authority to reduce system allowable revenue where QR has failed to provide access due to its own default or negligence.

4.1 Volume Increment

QR Proposal

QR's proposed arrangements include a volume-related 'increment' (being up to 2% of the total SAR for AT₂₋₄ tariff components) that QR could seek to retain when a year's actual tonnage exceeds forecasted tonnage and the AT₂₋₄ tariff components adjustment (before the increment is applied) is an over-recovery. Under these arrangements:

- *the volume increment is zero if the total actual revenue (for AT₂₋₄) is less than or equal to the SAR (for AT₂₋₄) for the relevant individual coal system infrastructure;*
- *a volume increment will exist if the total actual revenue (for AT₂₋₄) is greater than the SAR (for AT₂₋₄) for the relevant individual coal system infrastructure:*
 - *the size of the increment is to reflect the extent to which the difference between the total actual revenue and the SAR has arisen as 'a direct result of activities or initiatives of QR (or its contractors)' which have increased the efficiency of the below-rail network – but is limited to 2% of the total SAR; and*

- the increment would be a one off adjustment which would not be added to the system allowable revenue for subsequent years (Schedule F. Part B, cl. 3B.2).

Under these arrangements, QR could retain a volume increment for some systems, even when volumes were below forecast on others.

QR argued that the volume increment is ‘only intended to operate as a nominal, one-off incentive for QR where it contributes to improving supply chain efficiency’ and is not a mechanism designed to expose QR to volume risk (QR, sub. no. 1:24).

The proposed volume increment is based on QR’s proposed SAR and, as such, does not take account of QRNA’s underperformance in that it does not account for shortfalls that were caused by QRNA’s default or negligence (see discussion of the revenue cap approach in Section 1.2).

Stakeholder Comments

Stakeholders did not support QR’s proposed volume increment. PN suggested that a volume increment is not particularly suitable to drive the behaviour of a publicly owned rail infrastructure owner towards maximising revenue. It also argued that QR’s claims supporting its proposal were not compelling:

... it would appear that the intention is that the “revenue cap” is in fact a “revenue cap + up to 2%” and not a true revenue cap at all. ... It would be appropriate for QR, which admits it is attempting to move risk onto access contract holders, to provide a more robust argument as to why it should be granted what is in effect a substantial increase in the rate of return than QR would otherwise be permitted to earn. (PN, sub. no 5:8)

The QRC did not support QR’s proposed approach.

... QRNA’s proposal, involving an ability for QRNA to retain a 2% upside (subject to conditions), while being exposed to no downside, cannot be described as a “reasonable compromise”. (QRC, sub. no. 2:12)

Instead, the QRC proposed that QRNA be exposed to a +/- 2 per cent volume risk/incentive based on an adjusted SAR (reduced to reflect the effects of negligence by QRNA or a breach by QRNA of its obligations under any Access Agreement or under the Undertaking).

Failing that, the QRC proposed that QR’s proposed increment should not apply at all, or should be applied symmetrically. Under such an arrangement, QRNA could apply to retain an increment where SAR is exceeded but also could be subject to a ‘negative’ increment for any revenue shortfall, in addition to shortfalls due to QRNA failing to provide access due to its own default or negligence (QRC, sub. no. 2:12). Ensham and the RTCA supported the QRC’s view (RTCA, sub. no. 3; Ensham, sub. no. 4).

Authority’s Analysis and Draft Decision

The Authority accepts QR’s volume increment, subject to it being applied to a SAR that has been adjusted to the extent that actual revenue has been reduced to reflect the effects of negligence by QRNA or a breach by QRNA of its obligations under the access agreement or under the access undertaking (see Draft Decision 2).

The Authority considers that, under a revenue cap, an increment of this nature will provide QR with an incentive to improve performance while moving the majority of volume risk to the above-rail operators (and their customers). In this regard, the Authority notes that, under these arrangements, QR must demonstrate to the Authority that its activities or initiatives have increased the efficiency of the below-rail network for it to retain part of any over-recovery. If

not, the over-recovery is distributed amongst above-rail operators (and their customers) through the revenue cap adjustment mechanism.

That said, the Authority accepts that alternative arrangements could potentially provide better incentives to improve performance and accordingly welcomes the QRC's proposal to develop, for the next regulatory period, a set of performance incentives (involving both upside and downside risk for QRNA) which could replace this arrangement.

Draft Decision 6

The Authority accepts QR's volume increment, subject to it being applied to a system allowable revenue that has been adjusted to reflect the effects of negligence by QRNA or a breach by QRNA of its obligations under the access agreement or under the access undertaking (see Draft Decision 2).

4.2 Revenue Adjustment Mechanism

QR has proposed that 100% of the over- or under-recovery of SAR, adjusted for the volume increment (see above) be subsequently returned or recouped, through adjustments to the relevant reference tariff components in each system (Schedule F. Part B, cl. 3B.1 and 3B.2).

Under the arrangements, the value of the adjustment is determined following the end of each financial year as:

- an AT_{2-4} revenue adjustment – subtracting the SAR for AT_{2-4} from the total actual revenue for AT_{2-4} (including take-or-pay amounts, relinquishment fees and transfer fees, less any reductions related to those fees) in that system for that year; and
- an AT_5 revenue adjustment – subtracting the SAR for AT_5 from the total actual revenue for AT_5 in that system for that year (Schedule F. Part B, cl. 3B.1).

Any adjustments are made to the reference tariff calculations for the second financial year following the subject year and include an allowance for the funding of the net total of the adjustments using QR's discount rate (Schedule F. Part B, cl. 3B.3.2). When such an adjustment is made:

- QR will submit a variation to the relevant reference tariff that include details of the methodology, data and assumptions used to vary the reference tariff;
- the Authority may adjust the variation to reflect any decision it has made regarding the proposed increment; and
- the Authority will approve the proposed variation if it is satisfied that the variation recovers or returns the amount of the adjustment (Schedule F. Part A, cl. 3.3.7).

Stakeholder Comments

The QRC accepted QR's proposal, subject to its comments on the calculation of the volume increment, the main point being that:

... QRNA should be exposed to a low level of volume risk / incentive, as reflected in the [volume increment] proposal that a +/-2% variation from System Allowable Revenues should not result in an 'under/over' adjustment (QRC, sub no. 2:12).

The QRC also considered that, to the extent the actual revenue had been reduced as a result of the effects of negligence by QRNA or a breach by QRNA, stakeholders should be given the opportunity to notify the Authority.

QRNA's System Allowable Revenues should be reduced to the extent that Actual Revenue has been reduced as a result of the effects of negligence by QRNA or a breach by QRNA of its obligations ... In order to implement such arrangements, it may be necessary to create a process under which both the Access Holder and the ultimate customers (the mines) can notify the QCA of any reductions in available access which the Access Holder or customers consider arose as a result of such negligence or breach (sub no. 2:12)

Authority's Analysis and Draft Decision

The Authority accepts, in principle, QR's proposed revenue adjustment mechanism. However, the Authority requires QR to amend the associated provisions relating to reference tariff variations required as a result of a revenue cap adjustment (Schedule F, Part A, cl. 3.3.7).

In particular, as noted in Draft Decision 2, the Authority requires the amendment to provide for the Authority to consider whether QR has failed to provide access due to its own default or negligence when assessing any adjustment to SAR. As a consequence of this, the Authority requires QR to provide specifically for the Authority to make a determination regarding a deduction from SAR as part of the reference tariff variation.

In addition, in the interests of clarity, the Authority also requires QR to provide for the Authority to approve a proposed variation having regard to the entire revenue adjustment mechanism (contained in Schedule F, Part B, cl. 3B.3). While it appears that this may have been QR's intention, the Authority considers that QR's proposed arrangements (that refer to cl. 3B.3.3 in particular) could potentially be misconstrued to limit the matters the Authority can consider in assessing variations to reference tariffs that are the result of a revenue cap adjustment.

The Authority considers that ensuring the transparency and accountability of any revenue adjustments underpins the integrity of the regulatory framework. Accordingly, the Authority requires QR to provide a 'responsibility statement' signed by QR's Chief Executive that verifies that the information provided was truthful and accurate and contained all of the information required to be provided in support of any adjustment to the Authority at that time. The Authority notes that QR is required to provide similar assurances to the Authority as part of its regulatory reporting requirements and considers that the information provided to support any revenue cap adjustment is of at least equal importance.

Consistent with the QRC's proposal, the Authority requires that the undertaking provide for the Authority to publish details of QR's proposed variation (subject to confidentially) to provide stakeholders with an opportunity to comment on the proposed variations. While the Authority accepts that doing this will delay the date of making the amendment, it considers that providing for additional scrutiny is appropriate in these circumstances, particularly in assessing any adjustment to SAR. Furthermore, the Authority notes that the revenue adjustment occurs two years subsequent, and therefore time is available for the proposed assessment without impinging on any revenue adjustment.

3.1.7 Where QR submits a variation of a Reference Tariff in accordance with Subparagraph 3.3.1(b)(ii):

- (a) the variation must:
 - (i) nominate the Reference Tariff to be varied;
 - (ii) include details of the methodology, data and assumptions used to vary the Reference Tariff;

- (iii) include details of and reasons for any amount used in preparing that variation in lieu of an Increment having been determined by the QCA; and
- (iv) be accompanied by a responsibility statement, in respect of the information provided in relation to the variation, signed by the QR Chief Executive.
- (b) the QCA will publish details of QR's proposed variation of the relevant Reference Tariff and will invite and consider comments from stakeholders regarding the proposed variation;
- (c) the QCA may adjust the variation but only to the extent that:
 - (i) the QCA has made a determination under Subparagraph 3B.2.1(b) of Part B in relation to an Increment; or
 - (ii) the QCA has made a determination regarding a deduction from System Allowable Revenue under subparagraph (iii) of the definition in clause 5.2 of Part A;
- (d) the QCA will approve the proposed variation of the Reference Tariff if the QCA is satisfied that the variation of the Reference Tariff is in accordance with Clause 3B of Part B and subject to any adjustment under Paragraph 3.3.7(c).

In addition, for the purposes of calculation of the revenue adjustment amounts, the Authority notes that it has proposed that QR define total actual revenue such that QR will be deemed to have contracted on the terms of its SAA and QR is required to include any AT₂₋₄ and AT₅ revenue from access agreements that QR earned but failed, or was unable to collect during the relevant year (see Draft Decision 4).

Draft Decision 7

The Authority accepts, in principle, QR's proposed revenue adjustment mechanism (Schedule F, Part B, cl. 3B.3).

However, the Authority requires QR to amend the associated provisions relating to reference tariff variations required as a result of a revenue cap adjustment (Schedule F, Part A, cl. 3.1.7) to provide that:

- **the Authority to make a determination regarding a deduction from System Allowable Revenue to the extent that actual revenue has been reduced as a result of the effects of negligence by QRNA or a breach by QRNA of its obligations under the access agreement or under the access undertaking;**
- **QR must provide a 'responsibility statement' signed by QR's Chief Executive that verifies that the information provided was truthful and accurate and contained all of the information required to be provided to the Authority at that time; and**
- **the details of the proposed variations to reference tariffs be published.**

4.3 Other Amendments

As noted above, the Authority has required QR to amend the undertaking so that when capacity under an existing contract is transferred, the take-or-pay and relinquishment fees in the replacement (transferred) contract is based on the original arrangements, but only for the term of the original contract (see Section 2). To reflect this, the Authority has required QR to amend its proposed take-or-pay arrangements (in Schedule F and in the SAA) (Draft Decision 4). In addition, the Authority requires QR to make consequential amendments to cl.7.4.4 and the definitions of the access undertaking (see proposed drafting).

In addition to the amendments described above, the Authority requires QR to make the following minor change to drafting in the interests of clarity and comprehensiveness.

- Schedule F, Part A, cl. 3.3.2(b)(ii) – to allow the Authority to require QR to submit a variation to reference tariffs in accordance with the review adjustment mechanism, if QR has failed to do so.

The Authority has not adopted the QRC's additional proposals for drafting on the basis that these were not strictly necessary nor required given the Authority's proposed drafting.

LIST OF SUBMISSIONS

Organisation/Individual	Submission Number
Queensland Rail (QR)	1
Queensland Resources Council (QRC)	2
Rio Tinto Coal Australia (RTCA)	3
Ensham Resources (Ensham)	4
Pacific National (PN)	5