



Decision

QR's Proposed Schedule F Amendment

May 2007

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PREAMBLE

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

According to the processes contained in Part B of Schedule F of the access undertaking and its obligations under the *Queensland Competition Authority Act 1997* (QCA Act), the Authority must decide whether or not to approve QR's proposal within 60 days of receiving it, or longer if agreed by QR, or otherwise reasonably determined by the Authority. On 19 April 2007, the Authority extended the period in which it must decide whether or not to approve QR's proposal to 31 May 2007.

Stakeholder consultation

The Authority published QR's proposal, invited submissions on it and received four submissions.

Having regard to those submissions and its own analysis, the Authority released a draft decision to not approve QR's proposed Schedule F amendments and the associated changes to its Standard Access Agreements (SAAs).

The Authority invited submissions on the draft decision and received four additional submissions.

Pacific National (PN), the QRC and Rio Tinto Coal Australia (RTCA) generally supported the Authority's proposal, but objected to the Authority's proposal to accept a positive volume increment for improved performance.

While QR accepted the principles associated with the Authority's proposal, and supported the Authority's attempts to clarify how a hybrid revenue cap would work, it nevertheless requested that a number of the Authority's proposals be modified substantially or withdrawn. These included adjusting System Allowable Revenue (SAR) for breach or negligence by QR, the proposed treatment of transferred capacity, and amendments to the revenue adjustment mechanism.

In addition, stakeholders flagged their commitment to revisit a number of matters that had been canvassed in this process as part of the development and assessment of QR's next access undertaking.

Outline of Decision

In making this decision, the Authority has taken account of matters required under the process contained in the access undertaking. Under these arrangements, the Authority may approve a proposed Schedule F Amendment only if it is satisfied that the proposal is consistent with the access undertaking and the principles contained in Schedule F and considers it appropriate to do so having regard to s.138(2) of the QCA Act. The Authority must have published the proposal, invited

stakeholders to comment on it within a reasonable period of time and considered any submissions received within that time.

Given the submissions received in response to QR's proposal and to the Authority's draft decision, its own analysis, and independent advice, the Authority confirms its preliminary view to not approve QR's proposed Schedule F amendments and the associated changes to its SAAs.

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. While the Authority accepts, in principle, the move to a revenue cap it nevertheless 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 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 breach 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;
- the treatment of transferred capacity – the Authority requires QR to amend its proposal so that when access rights are transferred, the take-or-pay arrangements and relinquishment fees in the original contract are transferred to the replacement contract; 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.

The Authority has prepared detailed drafting which supports, and is consistent with, the principles raised in body of the decision.

Notice requiring QR to resubmit amended proposal

This decision constitutes a written notice for the purposes of cl 3.9 of Part B of Schedule F of the access undertaking.

It sets out the Authority's reasons for refusing to approve QR's proposed arrangements and its requirements about how QR should amend its proposal. In accordance with cl 3.9 of Part B of Schedule F of the access undertaking, the Authority requires QR to amend its proposal and resubmit an amended proposal within 30 days of this notice.

Way Forward

In accordance with the written notice, QR must resubmit an amended proposal by 25 June 2007. However, QR may request an extension of the time for resubmitting an amended proposal.

If QR complies with the notice, the Authority will approve the resubmitted proposal if it is satisfied that it is consistent with the access undertaking and principles contained in Schedule F and considers it appropriate to do so having regard to s.138(2) of the QCA Act.

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.

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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 introduce a hybrid revenue cap approach to replace the hybrid price cap approach that has been adopted to date.

The Authority accepts, 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, the Authority has sought to clarify the definition of the scope of the revenue cap (see section 1.1), has sought to introduce reasonable adjustments to the revenue cap (see section 1.2) and has not accepted QR's proposal to vary system forecasts from what was approved in the 2006 access undertaking (see section 1.3).

1.1 Definition of the Scope of the Revenue Cap

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 from 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; and
- there is a 'significant benefit' of having similar consistent regulatory frameworks within the coal supply chain as it assists in aligning the parties' incentives for contracting and investing in capacity (QR, sub. no. 1:6-7).

QR argued that system-by-system revenue caps provide a relatively simple mechanism that matches the under or over-recovery with allowable revenue, which has been determined on a

system-by-system basis. In addition, QR noted that a system-by-system 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 a single AT₅ revenue cap covering both systems. Accordingly, QR proposed to review the charging structure for electric traction during the development of future access undertakings.

Draft Decision

In its draft decision, the Authority accepted, in principle, QR’s proposal to use a hybrid revenue cap approach for coal-carrying train services in the CQCR – but had a number of concerns regarding QR’s proposed implementation of the new arrangements and, accordingly, required QR to amend its proposal to address these issues.

In its draft decision, the Authority accepted QR’s proposal to apply a revenue cap to QRNA’s ‘fixed’ costs, being tariff components AT₂₋₄ (excluding AT₁ the incremental maintenance charge) and the electric access tariff AT₅.

In addition, the Authority proposed that QR be required to ensure that the scope of the services included within the revenue cap be appropriately defined so that the costs of the services provided match the revenues from the services provided. For example, the Authority was concerned that coal-carrying train services that were not priced on the basis on tariff components AT₂₋₄ or only partially used the CQCR would be inadvertently excluded from the operation of the revenue cap.

The Authority was also concerned that the operation of the revenue cap be appropriately defined as access holders who have performed to contract volumes could be asked to make a further contribution if QR has not achieved its revenue targets because other access holders have underperformed (ie access holders could be asked to underwrite the commercial arrangements of a rival access holder). This is a particular concern when that rival is part of a vertically integrated organisation (see also section 2.1).

Stakeholder Comments on Draft Decision

In response to the draft decision, stakeholders reiterated their support, in principle, to move to a hybrid revenue cap – and supported arrangements which appropriately match costs and revenues (QR, sub. no. 6:5-6; QRC, sub. no. 7:2, RTCA, sub. no. 8, PN, sub. no. 9:1).

In this regard, QR confirmed that it intends to:

- include in the revenue cap all revenues for coal-carrying train services operating in the CQCR (ie for coal-carrying train services that do not operate exclusively in the CQCR, include those revenue associated with their operation on the CQCR); and
- exclude revenues associated with non-coal traffics (ie passenger and non-coal services) (QR, sub. no. 6:9).

On that basis, QR suggested the following amendments to the Authority’s proposal to identify coal-carrying traffics specifically and to clarify that the AT₅ reference tariff component only applied to electric haul coal-carrying train services.

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 coal-carrying Train Services in the Central Queensland Coal Region by reference to the same components as Reference Train Services (AT₁, AT₂, AT₃, AT₄, the QCA Levy, and AT₅ and EC if appropriate), even if the Train Service does not constitute a Reference Train Service.

Reflecting this, QR proposed to adjust system forecasts and System Allowable Revenue (SAR) to reflect those traffics that do not exclusively operate on the CQCR (see section 1.3).

The QRC also supported the proposal that the revenue cap apply only to the fixed elements of the access charge. While the QRC accepted arrangements that include AT₂₋₅ within the revenue cap (and exclude AT₁ and EC) for the remainder of the regulatory period, it considered that an independent analysis of the fixed - variable breakdown of QR's costs is required as part of the development of the next undertaking (QRC, sub. no. 7:2).

Authority's Analysis and Final Decision

On the basis of the matters raised by stakeholders in response to the Authority's draft decision, the Authority has not substantively changed its position on QR's proposal to use a hybrid revenue cap approach for coal-carrying train services in the CQCR.

The Authority confirms that it 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 considers that it is appropriate to limit the scope of the revenue cap to all coal-carrying train services on the CQCR – and notes that QR intends to adjust its revenue calculations to reflect revenues associated with train services that do not operate exclusively on the CQCR.

The Authority requires that QR construct access charges in the CQCR such that any revenue from those train services is included in the revenue cap. The Authority accepts QR's proposal to refine the proposed provisions relating to access charges in central Queensland (Schedule F, Part A, cl. 3.5.1) on the basis that these are consistent with the principles contained within Authority's draft decision.

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 Adjustments to System Allowable Revenue

QR's proposed revenue cap approach provides for QR to retain its 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 for adjustments 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).

Draft Decision

In its draft decision, the Authority did not accept QR’s proposed definition of SAR. Instead, the Authority proposed that the definition of SAR to be included in the access undertaking provide for an adjustment to the extent that QRNA fails to provide access due to its own negligence or to its own breach of an access agreement – but at the same time avoids double counting relating to contractual remedies.

In doing so, the Authority accepted that, in moving to a hybrid revenue cap, QR should not be materially exposed to volume risk, but did not consider that QR should recover its allowable revenue in all circumstances.

In addition, the Authority proposed that it would assess whether any adjustment to the SAR is required as part of its assessment of proposed variations to reference tariffs in response to revenue cap adjustments. In particular, the Authority proposed that it 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 breach of an access agreement, or its own negligence (Schedule F, Part A, cl. 3.3.7(c)(ii)).

Stakeholder Comments on the Draft Decision

Stakeholders’ response to the Authority’s draft decision regarding adjustments to SAR was mixed. While stakeholders accepted that a deduction from SAR is required, they did not agree on what should be included as a deduction and how this should be assessed.

QR accepted the principle that it should not recover revenue, via the revenue cap adjustment, in the event that it *wilfully* denies access to the below-rail network – but was concerned that the Authority has proposed arrangements that could have a substantially broader application than this (QR, sub. no. 6:7). In this regard QR argued that:

- the Authority did not justify why the proposed adjustments to SAR should go ‘substantially’ beyond arrangements for revenue cap approaches in other regulated businesses, and in particular the approach it has agreed for DBCT;

- the Authority did not propose a process for determining the existence of, or quantifying, a breach or negligence – and in particular was concerned that the onus will be placed upon QR, to ‘prove that a reduction in tonnage is *not* due to QR’s breach or negligence’; and
- introducing an adjustment for negligence requires a ‘thorough review of events’ which would be considered to be either a reasonable or unreasonable loss of available system capacity – and that it is unclear whether it is appropriate for the Authority to consider these matters (QR, sub. no. 6:8).

On this basis QR requested that the Authority withdraw its proposed definition of SAR and the associated provisions that provide for the Authority to adjust any proposed variation to reflect an adjusted SAR (Schedule F, Part A, cl. 3.3.7(c)(ii)). In support of its request, QR proposed a series of ‘drafting principles’ to form the basis of an alternative arrangement whereby:

- a breach of an access agreement must be a deliberate (ie wilful) one;
- QR must have failed to remedy or dispute the wilful breach within a reasonable period following receipt by QR of a written notice;
- disputes regarding breaches must be resolved via a pre-determined resolution process consistent with the SAA; and
- adjustments against SAR:
 - are linked to claims agreed between QR and the access holder, or resolved in accordance with a pre-determined resolution process consistent with the SAA;
 - reflect access charges that would have been payable by an access holder to QR had the breach not occurred; and
 - would not result in QR being penalised twice – firstly, under the reference tariff variation approved by the Authority, and secondly, by QR being obliged to forego payments and/or being required to pay compensation or damages under the contractual arrangements in the relevant access agreement (QR, sub. no. 6:8-9).

In contrast, the QRC argued that Authority’s proposed adjustment to SAR to reflect QR’s own default and negligence represents a ‘high’ threshold test which will ‘effectively insulate QR from the effects of its own performance in many cases’ (QRC, sub. no. 7:3). This was a particular concern for the QRC, since QR could apply for a positive volume increment, but was not exposed to any symmetrical negative increment where poor performance by QR (other than default or negligence) results in a loss of volumes.

Given this, the QRC requested that the Authority reconsider its position and introduce arrangements that achieve symmetry of QR’s downside and upside exposure for performance (see section 4.1). Failing that the QRC proposed that the Authority:

- raise the threshold for retaining a positive volume increment (see section 4.1); and
- reject any suggestions seeking to limit QR’s exposure to an adjustment for breach or negligence (eg defining the terms in a way that narrows the application of the adjustment) (QRC, sub. no. 7:3).

Authority's Analysis and Final Decision

On the basis of the matters raised by stakeholders in response to the Authority's draft decision, the Authority has not substantively changed its position on matters in relation to the SAR.

Deductions from System Allowable Revenue

The Authority maintains its view that providing for a deduction from SAR will provide appropriate incentives for QR to maintain its performance when moving from a price cap to a revenue cap. The Authority notes that stakeholders (including QR) have accepted that QR should not recover its revenue, via the revenue cap adjustment, in all circumstances — and that a deduction from SAR is appropriate in some circumstances.

The Authority has not accepted QR's proposal to limit provisions for deductions from the SAR beyond what was proposed in the draft decision. Instead, the Authority reaffirms that it requires QR to adjust the SAR to the extent that QR fails to provide access due its own breach of an access agreement, or its own negligence – but now subject to a materiality test. In doing so, the Authority notes that this proposal is consistent with the arrangements included in the SAA for claims for the non-provision of access.

In particular, cl. 15.3 of the SAA already provides for an access holder to make claims relating to the non-provision of access if QRNA fails to make infrastructure available as a result of breach or negligence (subject to a materiality constraint). Providing for a deduction from SAR for breach or negligence simply ensures that QRNA will not be able to use the revenue cap adjustment mechanism to recoup revenue which it is not entitled to earn under its access agreement because of breach or negligence.

At this time, the Authority has included a test for the materiality of the breach or negligence. This materiality test is also based on existing thresholds in the SAA on the basis that it will ensure consistency between the standard contract terms and the operation of the revenue cap mechanism. The Authority will monitor the operation of this test over the remaining regulatory period with a view to better informing itself on this matter for the next review of QR's access undertaking.

Assessing the Deduction from System Allowable Revenue

In its draft decision, the Authority proposed that it would assess whether any adjustment to the SAR 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). At the time, the Authority did not provide for a process to assess an adjustment to SAR other than to the extent that the Authority 'reasonably determines' revenues that QR is not entitled to earn due to its own breach of an access agreement, or its own negligence.

The Authority accepts that, in some circumstances, it might be difficult to assess whether a breach or negligence has occurred. Indeed, under the Authority's proposed arrangements, it could require a deduction from SAR only where it 'reasonably determines' that the loss of revenue was because of QR's own breach or negligence – so to the extent that the Authority does not have sufficient information to make such a determination, then a deduction could not be required. In this way, in practice the test may well represent, as the QRC suggests, a 'high threshold', since the Authority is only likely to be provided with information to support obvious or major breaches or negligence.

That being said, the Authority maintains that it is appropriate for it to consider these matters – and, accordingly requires that the undertaking include arrangements that provide *all*

stakeholders with the opportunity to convince the Authority of the merits of their positions including scrutinising other stakeholders' claims.

The Authority agrees with QR that, in the interests of transparency, there may be benefits from identifying clearly the process by which the Authority will make any such assessment.

However, the Authority is not satisfied that the proposed 'drafting principles' included in QR's submission in response to the draft decision provide a comprehensive framework for assessment – and accordingly cannot endorse those principles at this time.

While it might, in principle, be appropriate to link a deduction to a claim agreed or resolved between QR and an access holder, it is less clear that this is appropriate in practice given that the only access holder currently on the CQCR is QRNational. Given this, the Authority considers that access holders or other parties (mines) should be able to present information to the Authority regarding potential breaches or negligence. For example, by requiring that details of the proposed variations to reference tariffs be published (see Decision 8), it is likely that the Authority will be informed of events of breach or negligence (which the Authority would then seek to clarify with QR).

On that basis, the Authority envisages an arrangement that provides some flexibility to address issues beyond the access agreement, but which limits spurious claims or claims that have already been addressed elsewhere. In particular, the Authority is not seeking to commandeer other processes already on foot that seek to resolve such disputes.

Elsewhere in this decision, the Authority has highlighted its concerns about whether QRNA will agree to reasonable terms, or adequately enforce the terms, in access agreements with QRNational. The concern is that, if QR does not do this, then any revenue shortfall would be recouped through the revenue cap mechanism. Consistent with this, the Authority will assess any deduction from SAR on the basis of the deductions that an access holder would be entitled to make under the terms of the SAA.

Accordingly, the Authority requires QR to include arrangements in the access undertaking that clarify the process to assess deductions to SAR (see detailed drafting). In doing so, and in the absence of an alternative proposal, the Authority requires that the access undertaking clearly specify:

- those circumstances when an adjustment will be made (ie where the Authority is satisfied that QR is not entitled to earn revenue due to its own breach of an access agreement or its own negligence (subject to a materiality threshold) which QR has failed to remedy or which QR disputes);
- the process the Authority will follow in making any assessment including, but not being limited to:
 - the information to which the Authority must refer (ie including claims for breach or negligence made by an access holder, or otherwise provided by an affected party);
 - the calculation of the adjustment (ie to reflect revenues that would have otherwise been collected, or deductions that would be entitled to be made on the basis of the terms of the SAA, but that avoids double counting relating to contractual remedies); and
 - how the Authority will treat matters that are the subject of other proceedings (ie the Authority will not make a determination until those matters are finalised – and will be bound by any decision as to whether breach or negligence occurred).

In addition, 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 breach of an access agreement, or its own negligence (see Decision 8).

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 breach of an access agreement, or its own negligence.

The Authority requires QR to clearly specify those circumstances when an adjustment will be made and the process the Authority will follow in making any assessment. In doing so, 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 own breach or negligence (see Decision 8).

1.3 Proposed Revisions to System Forecasts and System Allowable Revenues

QR Proposal

QR 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; 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. Without quantifying the expected size of the revenue cap adjustments, QR 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).

Other than altering the profile of demand, QR relied on the same modelling parameters and assumptions used to determine the reference tariffs for its approved access undertaking. In doing so, QR noted that it had also 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 reprofiled tonnage forecast 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).

Draft Decision

In its draft decision, the Authority did not accept QR's proposal to revise system forecasts and SAR and instead proposed that QR be required to maintain current approved forecasts and current SAR.

At the time, the Authority noted that stakeholders, who are ultimately affected by revenue cap adjustments, strongly objected to QR's proposal – and that it was not clear why it was necessary for QRNA to revise forecasts and SAR in this way since its effect on QRNA, is revenue neutral (in net present value terms) over the regulatory period.

Stakeholder Comments on the Draft Decision

In response to the draft decision, stakeholders accepted the Authority's proposal to reject QR's proposal to revise system forecasts and instead require that QR maintain current approved forecasts and current SAR. In doing so, the QRC and RTCA reiterated the industry's strong opposition to QR's proposal to revise system forecasts (QRC, sub. no. 7:4; RTCA, sub. no. 8).

While QR accepted the Authority's draft decision on this matter, it considered that 'notwithstanding the comments of the consultees, there continues to be a number of valid reasons why the system forecasts should be adjusted' (QR, sub. no. 6:9). On that basis, QR proposed that all system forecasts and SAR reflect the Authority's June 2006 decision, and system forecasts and SAR also be adjusted to reflect 'non-exclusive' coal-carrying train services. For example, the Blackwater cluster will be adjusted to include traffic from the Springsure branch which was not included in QR's original application (QR, sub. no. 6:9).

Authority's Analysis and Final Decision

Given stakeholders' comments, the Authority confirms its proposals to require QR to maintain current approved forecasts and current SAR.

As noted above, the Authority considers that QR's 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 (see section 1.1).

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 this as the basis for the SAR – ie include the SAR that was implicit in the reference tariffs that the Authority approved in its June 2006 final approval plus revenues from any 'non-exclusive' coal-carrying traffics (see section 1.1). On this basis, the Authority has calculated the SAR for each of the central Queensland coal systems as shown in Table 1.

Table 1: System Allowable Revenues AT₂₋₄ and AT₅

<i>System</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>
Blackwater ¹	126,859,868	139,015,262	149,342,562
Goonyella	116,283,563	129,999,304	135,237,488
Moura	28,440,217	28,844,853	35,020,874
Newlands	23,307,925	24,419,331	25,029,814
Total (AT₂₋₄)	294,891,573	322,278,750	344,630,738
Blackwater	24,842,392	22,077,579	29,414,137
Goonyella	35,903,380	39,889,312	41,321,504
Total (AT₅)	60,745,773	61,966,891	70,735,641

¹Blackwater system revenues have been adjusted to include the common cost contribution made by non-exclusive coal-carrying traffic on the Gindie-Minerva line.

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 (adjusted to reflect 'non-exclusive' coal-carrying traffics).

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 considers revenue amounts that QRNA is entitled to be paid, regardless of whether QRNA in fact collects that amount. The Authority also requires renewed access agreements be subject to the same take-or-pay arrangements as new access agreements executed under the 2006 access undertaking – but that 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.

The Authority accepts QR's proposal to maintain existing relinquishment fees for access agreements signed prior to 2006 access undertaking – but requires QR to address the inconsistency between the description included in the access undertaking and the actual arrangements made at that time. In addition, and in a similar way to its requirements for take-or-pay, the Authority requires that where access rights are transferred, the relinquishment fee arrangements in the original contract will be transferred to the replacement contract.

The Authority is considering 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.

Draft Decision

In its draft decision, the Authority accepted, in principal, QR's proposal to strengthen take-or-pay arrangements for UT2 access agreements, but required QR to clarify how the take-or-pay arrangements will be applied in practice.

In particular, the Authority proposed that QR include arrangements such that new or renewed agreements are subject to stronger take-or-pay arrangements. The Authority accepted concerns raised by PN that this creates different arrangements for UT1 and UT2 access holders. The Authority was, nevertheless, satisfied that to the extent that a difference exists, it will diminish over time as existing contracts expire and the replacement contracts take up the new arrangements.

In addition, the Authority sought to ameliorate PN's concerns by proposing 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 proposed that QR ensure that transferred capacity is not treated as a new contract and, therefore, does not take up the stronger take-or-pay arrangements. In doing so, the Authority sought to reduce any advantage that an 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.

The Authority proposed that QR be required to amend its proposed take-or-pay arrangements (in Schedule F and in the SAA) such that QR always considers the amount of take-or-pay which QRNA would be entitled to be paid from all access agreements, regardless of whether QRNA in fact collects this amount, in making take-or-pay calculations and determining take-or-pay amounts. The Authority also proposed that QR be required to amend its definition of total actual revenue such that it will:

- be deemed to have contracted on the terms of its SAA; and
- include revenue from access agreements (ie AT₂₋₄ and AT₅ revenue, take-or-pay amounts, relinquishment fees and transfer fees) that QR earned but failed, or was unable to collect during the relevant year.

Stakeholder Comments on the Draft Decision

Stakeholders' responses to the Authority's draft decision regarding QR's proposed take-or-pay arrangements were mixed – the key difference being in relation to the Authority's proposed treatment of transferred capacity.

QR and the QRC agreed that renewed access agreements should be on the same footing as new access agreements – although QR suggested that it was not necessary to make amendment as this principle is already reflected in QR's existing practices with respect to renewing access rights (QR, sub. no. 6:11).

Arrangements for transferred capacity

PN, the QRC and RTCA supported the Authority's proposal to preserve the existing take-or-pay (and relinquishment fee) arrangements where access rights have been transferred from a pre-existing agreement (PN, sub. no. 9:3, QRC, sub. no. 7:4, RTCA, sub. no. 8).

PN agreed that the Authority's proposal seeks to address an imbalance between new entrants and incumbents (on transferred capacity), but nevertheless argued that it may be the case that different arrangements will potentially apply to essentially the same hauls – and that the impacts of these disparities (and any future arrangements) have the potential to remain into the long term (PN, sub. no. 9:3).

While QR agreed that stronger take-or-pay arrangements *may* disadvantage new access seekers, it rejected the Authority's proposal for transferred capacity. In particular, QR argued, among other things, that:

- the Authority's proposed change is beyond the scope of matters able to be considered through the Proposed Schedule F Amendment – ie, the Authority's proposal is not consistent with, nor is it a consequence of, any proposal in QR's Proposed Schedule F Amendment;
- the Authority should be convinced of strong public interest reasons before amending the position 'agreed to between QR and the QRC'. QR noted that this issue was not raised by either QR or the QRC during the consultation process and, in the event that it had been, QR would not have agreed to any amendment to reflect the Authority's proposal;
- the proposed arrangements represent a material change to capacity management arrangements (contained in Part 7 of the access undertaking) and that it is not appropriate to 'grandfather' one contractual provision without consideration of the other provisions and their effect on this allocation;
- QR 'doubts' that the weaker take-or-pay arrangements are a barrier to transferring access – and that this issue is immaterial relative to other matters which a mine must also consider, eg the termination costs associated with an above rail haulage contract; and
- the Authority's proposal is unlikely to incentivise mines to move away from existing above-rail arrangements, to the extent that QRNational has not generally passed on the UT1 take-or-pay arrangements to its haulage customers (QR, sub. no. 6:11-13).

On that basis, QR requested the Authority to withdraw its proposal relating to transferred capacity – and instead advised that it would work with the QRC and PN to develop a revised set of capacity management arrangements, including for take-or-pay amounts, relinquishment fees and transfer fees, as part of QR's development of the replacement undertaking (QR, sub. no. 6:13).

Defining the Revenue which QRNA is Entitled to Earn

While QR accepted the Authority's proposal that revenues should include amounts that QR is entitled to earn (rather than the revenue collected), it argued that for this purpose QR should be deemed to have contracted on the terms of the relevant access undertaking (and not, as the Authority proposed, the terms of the SAAs).

QR noted that Schedule F of the access undertaking provides a degree of flexibility to negotiate terms and conditions which differ from the SAA – and accordingly argued that it should not be

penalised in the event that it negotiates arrangements with an access seeker which are consistent with the access undertaking but are inconsistent with the SAA (QR, sub. no. 6:14).

QR also requested that in calculating revenues which QR is entitled to earn, the Authority include transfer fees.

Authority's Analysis and Final Decision

On the basis of the matters raised by stakeholders in response to the Authority's draft decision, the Authority has not substantively changed its position on take-or-pay arrangements. It has however, refined its definition of the revenue that QR is entitled to earn, to better reflect QR's ability to contract on terms other than the SAA.

Arrangements for transferred capacity

The Authority confirms its proposals relating to take-or-pay arrangements for transferred capacity.

While the Authority accepts that this issue may not have been canvassed as part of the initial QR-QRC consultations, it nevertheless considers that these amendments appropriately address issues raised by stakeholders. Indeed, the Authority notes the strong support for these arrangements from the QRC, RTCA and PN.

The Authority does not accept QR's claim that the proposed arrangements for transferred capacity are beyond the scope of the Proposed Schedule F Amendment. In this regard, the Authority notes that:

- cl. 3.3 of Part B of Schedule F of the access undertaking includes the take-or-pay arrangements to apply from 1 July 2006 as within the scope of proposed amendments; and
- there is nothing restricting these arrangements from separately dealing with the narrower issue of how take-or-pay will be dealt with in transferred UT1 access agreements.

The Authority notes QR's concern regarding 'grandfathering' one contractual provision, without reference to others. However, the Authority considers that in this instance, this is appropriate – to reduce 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.

The Authority has maintained its requirement that QR include a number of amendments relating to relinquishment fees for transferred capacity (see section 2.2). However, the Authority has not sought to include transfer fees within the capacity transfer arrangements on the basis that these are beyond the scope of the Schedule F Amendment.

Defining the Revenue which QRNA is Entitled to be Earn

The Authority confirms its position that QR must always consider the amount of take-or-pay which QRNA would be entitled to be paid from all access agreements, regardless of whether QRNA in fact collects this amount.

The Authority accepts that it is open to QR to contract on terms different to the SAA, but within the constraints of undertaking (including on the basis of cost or risk). However, the Authority

maintains its position that QRNA should bear the risk of any decision it makes to contract on terms other than this.

On this basis, the Authority considers that the appropriate reference point is still the SAA (other than to the extent that the arrangements have been altered in accordance with the undertaking).

The Authority believes that this arrangement will have a symmetrical impact on QR. For example, if a QR signs an access agreement where it bears:

- lower cost or risk in comparison to the reference train, then the reference tariff, and the associated revenue, should be lower. QR should not be able to recoup the reduced revenue (through the revenue cap mechanism) from other access holders because it has not borne all of the costs associated with servicing the reference train; or
- higher cost or risk in comparison to the reference train, then the reference tariff, and the associated revenue, should be higher. QR should not be penalised (through the revenue cap mechanism) by not being able to retain the additional revenue as it has borne costs in addition to those normally associated with servicing the reference train.

In addition, the revenue associated with capacity consumption for trains with different section run times in comparison to the reference train should be included in the revenue cap as it is a price signal for capacity consumption and not compensation for QR having to bear additional costs.

The Authority confirms its position that for completeness, QR must include any AT₂₋₄ revenue (including AT₂ multiplier revenue) and AT₅ revenue from access agreements that QR earned but failed, or was unable to collect during the relevant year. In doing so, QR should consider take-or-pay amounts, relinquishment fees and transfer fees which QR is entitled to be paid.

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 (other than to the extent which it has been altered in accordance with the terms of the access undertaking); and**
- **QR is required to include any AT₂₋₄ (including AT₂ multiplier revenue) and AT₅ revenue from access agreements and take-or-pay amounts, relinquishment fees and transfer fees 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 current 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).

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. To address these matters, 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.

Draft Decision

In its draft decision, the Authority accepted QR's proposal to maintain existing arrangements for relinquishment fees for access agreements signed prior to 30 June 2006. However, the Authority also required QR to include a number of consequential changes relating to those 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.

Stakeholder Comments on the Draft Decision

Stakeholders did not object to the Authority's proposal to maintain existing arrangements for relinquishment fees for access agreements signed prior to 30 June 2006. However, QR and the QRC noted that the description of these relinquishment fees (contained in the Part 10 Definitions and in the approved SAAs) appears to be incorrect – being different to actual arrangements (ie the description contained in the 2001 access undertaking and in QR's internal access agreements) (QR, sub. no. 6:15; QRC, sub. no. 7:4).

The QRC claimed that the inconsistency should be corrected (QRC, sub. no. 7:4). In contrast QR claimed that there are no commercial consequences associated with this inconsistency (so a consequential amendment would be unnecessary), or the change would be out of scope (to the extent that the inconsistency relates to the definition applying to non coal-carrying services) (QR, sub. no. 6:15-16).

QR also reiterated the concerns it raised in the context of take-or-pay arrangements for transferred capacity (see section 2.1) in the context of a similar proposal for relinquishment fees.

Authority's Analysis and Final Decision

In the absence of comments from stakeholders to the contrary, the Authority confirms its proposals to require QR to maintain existing arrangements for relinquishment fees for access agreements signed prior to 30 June 2006.

The Authority notes that the description of these relinquishment fees appears to be inconsistent with the definitions used and actual arrangements made at that time. The Authority does not accept QR's claim that resolving this inconsistency is not necessary, and notes that the QRC have raised this as a concern. The Authority considers that, for coal-carrying services, an amendment of this nature is clearly within the scope of the Proposed Schedule F Amendment. In this regard, the Authority notes that cl. 3.3 of Part B of Schedule F of the access undertaking includes relinquishment fees for access agreements signed prior to 30 June 2006 as within the scope of proposed amendments. On that basis, in the interests of clarity, the Authority requires QR to amend the definition to resolve this inconsistency. The Authority accepts that an equivalent amendment that resolves the discrepancy for non-coal traffics is beyond the scope of the Proposed Schedule F Amendment. On this matter, the Authority would anticipate that this could be dealt with through a draft amending undertaking, or as QR suggests, in the development of future access undertakings.

While the Authority notes QR's concerns regarding transferred capacity, it nevertheless considers that the amendments the Authority has proposed relating to relinquishment fees are within scope as they relate to relinquishment fees for access agreements signed prior to 30 June 2006 (and allow the preservation of those rights if they are transferred to replacement agreements). On that basis, the Authority maintains its requirement that QR include a number of amendments relating to relinquishment fees for transferred capacity. 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.

Decision 5

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

The Authority requires QR to amend its proposed relinquishment fee arrangements such that:

- **the description of relinquishment fees for access agreements signed prior to 30 June 2006 reflects the definitions used and actual arrangements made at that time; and**
- **where access rights are transferred, the relinquishment fee arrangements in the original contract will be transferred to the replacement contract for the term of the original contract.**

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.

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

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

Draft Decision

In its draft decision, the Authority proposed that QR be required to redefine the 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.

In doing so, the Authority sought to allow QRNA to review reference tariffs, in response to significant changes, through a review mechanism that is more flexible than an amending undertaking but which excludes minor or unnecessary changes.

Stakeholder Comments on the Draft Decision

In response to the draft decision, stakeholders did not object to the Authority's proposal to require QR to redefine its definition of a review event (QRC, sub. no. 7:4, RTCA, sub. no. 8) – although QR did not believe that the Authority's proposal was a material improvement on QR's original position, noting that it was unlikely that QR would initiate a review event in accordance with the undertaking without first consulting with the Authority, or if necessary, the QRC (QR, sub. no. 6:17). In addition, QR proposed to review both the definition of Review Event and the practical application of Clause 3.3 of Part A relative to a voluntary draft amending access undertaking as part of its development of a future access undertaking.

Authority's Analysis and Final Decision

Given stakeholders' comments, the Authority confirms its proposal to require QR to amend the 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.

The Authority notes that this arrangement provides QR with flexibility to seek to review reference tariffs in response to significant changes – and is consistent with arrangements that require that the Authority 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)).

Decision 6

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 (see 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 (see section 4.2).*

The Authority accepts QR's volume increment, subject to QR providing for the Authority to reduce system allowable revenue where QR has failed to provide access due to breach, or negligence and linking payment of the increment to whole of coal chain activities and initiatives that improve below-rail efficiency.

The Authority accepts, in principle, QR's proposed revenue cap adjustment mechanism, but requires QR to clarify how this arrangement will be applied in practice. In particular, in the interests of ensuring the transparency and accountability of any revenue adjustments, the Authority requires that QR amend its proposal such that:

- *the Authority can approve a proposed variation having regard to the entire revenue adjustment mechanism; and*
- *the Authority can publish details of the proposed variations to reference tariffs, to the extent the Authority considers it appropriate to do so.*

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;
- 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:
 - 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 SAR 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 other systems.

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 own breach or negligence (see discussion of the revenue cap approach in section 1.2).

Draft Decision

In its draft decision, the Authority proposed to accept QR’s volume increment, subject to it being applied to an adjusted SAR.

At that time, the Authority considered 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 noted that, 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.

Stakeholder Comments on the Draft Decision

Stakeholders’ responses to the Authority’s draft decision to provide for a volume increment volume increment were mixed.

QR argued that the volume increment will provide QR with a ‘financial incentive to work with coal industry stakeholders to improve the efficiency of the coal supply chain’ (QR, sub. no. 6:19).

In contrast, PN, the QRC, and RTCA argued that that providing for QRNA to retain a positive incentive, while being exposed to no downside risk, was not appropriate (PN, sub. no. 9:3; QRC, sub. no. 7:3, RTCA, sub. no. 8).

A general concern was that the arrangements proposed by the draft decision were not balanced.

The QRC remains concerned that QRNA ... faces no downside risk in regard to its own performance, except to the extent that any under-performance amounts to negligence or default. Insulating QRNA from the ramifications of their performance so completely is an ongoing industry concern in the context of the move to a revenue cap and the substantial transfer of volume risk to the industry which accompanies this change. (QRC, sub. no. 6)

While it is accepted that the QCA is persuaded by the argument that the proposed model provides an incentive to QR to perform, it is unclear why, if this is the case, the logic would not extend to providing a negative incentive in the form of up to a 2% under-recovery where circumstances warranted. The Draft Decision did not seem to canvas any compelling reason for adopting what appears to be an unbalanced approach. (PN, sub. no. 9:3)

Reflecting this, the QRC reiterated its previous submission that QR should either be exposed to a low level of volume risk; or be exposed to a negative increment where poor performance by QR results in a loss of volumes; or not be entitled to earn a positive increment. The QRC argued that this achieved symmetry of downside and upside risk for QR (QRC, sub. no. 7). RTCA supported the QRC’s view (RTCA, sub. no. 8).

In addition, the QRC argued that providing a positive increment for activities which have increased the efficiency of the below-rail network is not appropriate since the operating costs included in allowable revenues already compensate QR for the costs of identifying and implementing such efficiencies. On that basis the QRC argued that providing for a volume increment allows QRNA to receive extra revenue by doing no more than ‘any competent railway manager would be expected to do’ (QRC, sub. no. 7:3).

On this basis, the QRC argued that the threshold for QR retaining an increment should be raised – by limiting the increment to apply only where ‘activities of QR have increased the efficiency of the below-rail network, and the Authority considers that these activities extend beyond what would reasonably be expected of a competent railway manager’ (QRC, sub. no. 7:3).

PN noted that payment of the volume increment is at the discretion of the Authority – and that there are no substantive criteria that would assist either QR or other interested parties in understanding the basis for such a payment. PN argued that any payment should be based on a very simple and unambiguous measure (eg being directly related to volume throughput) and should be applied symmetrically (PN, sub. no. 9).

QR and the QRC appeared to accept that it may be appropriate to develop a longer term solution (eg performance incentive regime) as part of the development of next access undertaking (QR, sub. no. 6, QRC, sub. no. 7). However, the QRC was concerned that moving towards a symmetrical performance incentive regime in the future may be problematic if ‘QR enjoys an asymmetric arrangement’ for the remainder of this regulatory period (QR, sub. no. 7:3).

Authority’s Analysis and Final Decision

On the basis of the matters raised by stakeholders in response to the Authority’s draft decision, the Authority has not substantively changed its position on matters relating the volume increment, but requires QR to refine the test for payment of that increment.

In particular the Authority accepts QR’s proposal to provide for a 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; and
- payment of the increment being conditional on QR demonstrating to the Authority that it has undertaken whole of coal chain activities or initiatives that have increased the efficiency of the below-rail network.

The Authority remains satisfied that a (positive) volume increment (applied to an adjusted SAR) provides QR with an incentive to improve performance while moving the majority of volume risk to the above-rail operators (see section 1.2).

One of the features of a revenue cap is that it will encourage QR to undertake productivity improvements as it can retain the benefits of the cost savings for the term of the undertaking. However, it also provides an incentive for QR to simply cut costs which brings with it the risk that QR will become less interested in maintaining or improving its performance levels. It is for this reason that the Authority has provided for deductions to be applied to a SAR 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 Decision 2).

In addition to this, QR has argued that it should have an additional financial incentive to work with the coal industry stakeholders to improve the efficiency of the coal supply chain.

The Authority has acknowledged the importance of providing a financial incentive to encourage a regulated entity to participate in improving the performance of the coal supply chain (for example see the Authority's April 2005 decision on the DBCT's access undertaking (p. 120)). The Authority considers that this is equally applicable to rail, as otherwise QR could become introspective and only focus on those matters that improve their own performance with little regard to the impact that may have on the performance of others in the coal supply chain.

However, in reconsidering this matter in light of draft decision submissions, the Authority notes that the proposed test related only to activities or initiatives which have increased the efficiency of the below rail network. In this regard, the Authority agrees with the QRC that improving the efficiency of the below rail network is a fundamental duty of a competent railway manager – and that QR should not be able to earn 2% above its revenue cap, for achieving those efficiency gains.

Accordingly, the Authority requires QR to link the payment of the volume increment to whole of coal chain activities or initiatives. The Authority considers that this better aligns QR's stated objectives for the volume increment and the likely outcomes – so that QR has an incentive to improve performance specifically relating to the coal supply chain, but can not make claims for other activities and initiatives it undertakes as a competent railway manager. In doing so, the Authority accepts that the volume increment is not a mechanism designed to expose QR to volume risk.

While the Authority has not provided for an equivalent negative volume increment (to the extent that QR undertakes coal chain activities that reduce the efficiency of the coal supply), it has provided for deductions for underperformance (to the extent that SAR is reduced for breach or negligence).

The Authority accepts that its proposed arrangements did not include specific criteria relating to the Authority's determination of whether QR's activities or initiatives have increased efficiency. However, the Authority notes that other arrangements now included in the access undertaking:

- limit the size of the increment paid – to 2% of the total SAR for AT₂₋₄ tariff components;
- require that the Authority be 'reasonably satisfied' that any difference between the total actual revenue and SAR has arisen as a direct result of whole of coal chain activities or initiatives of QR which have increased the efficiency of the below-rail network, before agreeing to an increment; and
- increase the transparency of the Authority's decisions – to the extent that the Authority can publish details of any variations to reference tariffs.

Given QR has an incentive to provide the Authority with convincing arguments and associated information to support a claim, and that this information is open to public scrutiny, the Authority has not required the undertaking include additional criteria on this matter.

The Authority accepts that alternative arrangements could potentially provide better incentives to improve performance and accordingly welcomes proposals to develop, for the next regulatory period, a set of performance incentives which could replace this arrangement.

On that basis, the Authority will monitor the operation of the volume increment over the remaining regulatory period with a view to better informing itself on this matter for the next review of QR's access undertaking.

Decision 7

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 (see Decision 2); and**
- **payment of the increment being conditional on QR demonstrating to the Authority that QR has undertaken whole of coal chain activities or initiatives that have increased the efficiency of the below rail network.**

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 AT₂₋₄ revenue adjustment – subtracting the SAR for AT₂₋₄ from the total actual revenue for AT₂₋₄ (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 AT₅ revenue adjustment – subtracting the SAR for AT₅ from the total actual revenue for AT₅ 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).

Draft Decision

In its draft decision, the Authority proposed to accept, in principle, QR's proposed revenue adjustment mechanism – but required amendments to the provisions in the interests of transparency, clarity and completeness. In particular, the Authority proposed that the Proposed Schedule F Amendments should provide for:

- the Authority to approve a proposed variation having regard to the entire revenue adjustment mechanism;
- the Authority to make a determination regarding a deduction from SAR as part of the reference tariff variation;

- QR be required to provide a ‘responsibility statement’ with any proposal to vary reference tariffs that verifies that the information provided was truthful and accurate and contained all of the information required; and
- the undertaking provide for the Authority to publish details of QR’s proposed variation (subject to confidentiality) to provide stakeholders with an opportunity to comment on the proposed variations.

Stakeholder Comments on the Draft Decision

With one exception, stakeholders generally did not object to the Authority’s proposals relating to the revenue adjustment mechanism (QR, sub. no. 6:19-21, QRC, sub. no. 7:5, PN, sub. no. 9:3). However, QR questioned why the Authority would oblige itself to publish details of the proposed variations to reference tariffs since the process for calculating the revenue cap adjustment will have already been agreed, much of the detail contained in the supporting information will be confidential, and it will be difficult for industry to comment in sufficient detail on any variation, except in the instance where QR has applied for a volume increment. On that basis, QR recommended that the Authority should not be required to publish details of the Reference Tariff variation, but have the discretion to do so (QR, sub. no. 6:21).

In addition, QR requested that the Authority withdraw its proposal requiring QR to attach a responsibility statement to a variation of reference tariffs. QR suggested that requiring QR to provide a responsibility statement:

- appears to be unnecessary — since QR’s Chief Executive is already accountable for QR’s compliance with all of its obligations under the access undertaking and that at ‘a minimum’ every submission for reference tariff variations will be signed by the Group General Manager of QRNA, who reports directly to the Chief Executive;
- was not required from other regulated businesses nor for other variations of reference tariffs (endorsed variations and review events, or variations under the draft amending undertaking processes); and
- had not been proven to improve the transparency and accountability of information where it had been provided (ie with the information requirements set out in Part 9 and Schedule MB of the access undertaking) (QR, sub. no. 6:19-21).

QR also noted that this issue had not been discussed between QR and the QRC, nor was it raised by stakeholders in response to QR’s proposal (QR, sub. no. 6:19).

Authority’s Analysis and Final Decision

On the basis of the matters raised by stakeholders in response to the Authority’s draft decision, the Authority has refined its position relating the revenue adjustment mechanism.

In particular, as noted in 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 breach 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.

The Authority maintains that publishing details of any proposed variation (subject to confidentiality) provides additional transparency that is likely to be appropriate in these circumstances particularly, where QR is seeking to retain a volume increment. However the Authority also accepts that there could be circumstances where it is not appropriate to publish information, including when that information is confidential.

On that basis, the Authority has refined its requirement that the access undertaking provide for the Authority to publish details of any proposed variations to the extent the Authority considers it appropriate to do so (and to the extent that it does this, it will invite and consider comments from stakeholders).

While the Authority maintains that ensuring the transparency and accountability of any revenue adjustments underpins the integrity of the regulatory framework, it no longer require QR to provide a ‘responsibility statement’ with the information it provides in support of its claims. In this regard, the Authority notes that to do so would create inconsistencies in the circumstances where QR would be required to provide a responsibility statement. That said, the Authority considers that it is particularly important that QR provide the Authority with accurate information to support its claims at the time that the revenue adjustment/reference tariffs are calculated.

In any event, the Authority continues to monitor the effectiveness of the responsibility statements where they currently apply and will monitor the type and nature of the information that QR provides the Authority to support proposed variations to reference tariffs with a view to better informing itself on the nature and scope of responsibility statements for the next review of QR’s undertaking.

Decision 8

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 approve a proposed variation having regard to the entire revenue adjustment mechanism;**
- **the Authority 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; and**
- **the Authority publish details of the proposed variations to reference tariffs, to the extent the Authority considers it appropriate to do so.**

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) (Decision 4). In addition, the Authority requires QR to make consequential amendments to cl.7.4.4 and the definitions of the access undertaking (Decision 5).

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 accepted QR's recommendation to amend the timeframes for submitting reference tariff variations (Schedule F, Part A, cl. 3.3.2(b)(ii)) since it is already the open to Authority to grant QR an extension of the time for submitting a variation of a reference tariff (Schedule F, Part A, cl. 3.3.3))

LIST OF SUBMISSIONS

Organisation/Individual	Submission Number
Queensland Rail (QR)	1, 6
Queensland Resources Council (QRC)	2, 7
Rio Tinto Coal Australia (RTCA)	3, 8
Ensham Resources	4
Pacific National (PN)	5, 9