

File Ref: 199123

22 November 2007

Mr John Prescott
Chairman of the Board
Queensland Rail
GPO Box 1429
Brisbane Qld 4001

Dear Mr Prescott

QR's Voluntary Draft Amending Access Undertaking – CPI Adjustment Application

On 16 October 2007, QR sought the Authority's approval to amend its current access undertaking so that system allowable revenues and revenue cap adjustments reflect actual CPI changes, not a forecast change of 2.5% per annum.

On 17 October 2007, the Authority invited interested parties to comment on QR's proposal. The Authority received submissions from Asciano, the Queensland Resources Council (QRC) and the Australian Rail Track Corporation (ARTC).

In accordance with its obligations under the QCA Act, the Authority has considered QR's proposal and the submissions made by stakeholders.

The Authority's draft decision is to not accept QR's application. The Authority considers that regulatory certainty is very important for all parties (including QR Network Access, QR National, other access holders, access seekers and end users) and should not be compromised by re-opening the access undertaking part-way through its term unless there has been a substantial change in circumstances. The Authority considers that the current circumstances are insufficient to justify such action.

The Authority notes that QR did not explicitly address the issue of regulatory certainty in its submission. QR now has an opportunity to address this issue or respond to any other matters it considers relevant.

Draft Decision

The QCA Act requires the Authority to consider a Draft Amending Access Undertaking (DAAU) submitted to it for the purpose of amending an approved access undertaking having regard to s.138(2) of the QCA Act. Under s.138(2), the Authority may approve a draft access undertaking only if it considers it appropriate to do so having regard to:

- the legitimate business interests of the owner or operator of the service;
- the public interest, including the public interest in having competition in markets;

- the interests of people who may seek access to the service; and
- any other matter the Authority considers relevant.

In arriving at its decision, the Authority has considered QR's proposal and supporting information and submissions from stakeholders. It has also undertaken its own analysis.

QR's Proposal

QR proposed to amend its approved access undertaking to provide for system allowable revenues to be escalated consistent with the actual CPI movement which is currently applied to reference tariffs (and thus to QR's total actual revenue). To do this, QR sought to adopt a 'minimalist approach', which involves amending:

- the definition of system allowable revenue (cl.5.2 of Part A of Schedule F) – to allow for system allowable revenues to be adjusted in line with actual CPI movements; and
- provisions relating to variations to reference tariffs (cl.3.3.7 of Part A of Schedule F) – to allow system allowable revenues to be adjusted by actual CPI movements in determining the revenue cap adjustment amount and subsequent reference tariffs.

QR also proposed to make adjustments to its reference tariff model to align the escalation of system allowable revenue with total actual revenue.

In support of its proposal, QR argued that the amendments are required because, under its revenue cap, it now faces inflation risk that it never intended to assume and that it had not been exposed to previously. QR argued that, given the outlook for the CPI for the remainder of the regulatory period, if the amendments are not made it will incur a revenue shortfall that it is unlikely to recover.

Stakeholders' Comments

Stakeholders' responses to QR's proposal were mixed. Asciano and the ARTC broadly supported QR's proposed amendments. The QRC did not support QR's claim as a matter of principle and raised a key concern about QR's apparent approach to the regulatory process.

Asciano shared QRC's concern regarding QR's apparent approach to the regulatory process, including the 'almost continual' amendment of the approved access undertaking. It viewed QR's repeated errors as indicating 'a lack of reasonable care in seeking regulatory approval', with QR adopting an approach of identifying errors ex post and seeking to 'correct them to its own benefit'. Asciano argued that this approach undermines the fundamental role that the undertaking should have in providing access seekers with the confidence necessary to compete with QR to provide train services.

Authority's Considerations

In the Authority's view, it is inappropriate for QR to seek to continually amend its approved access arrangements, although it recognises that there may be circumstances that justify amendments to an undertaking part-way through its term. Under the QCA Act, QR is entitled to submit a voluntary DAAU at any time – and the Authority must consider it on its merits, having regard to the matters mentioned in s.138 of the QCA Act. Having done so in this case, the Authority has taken the view that circumstances do not justify the amendments that QR has proposed.

Regulatory certainty and stability are important to all parties affected by an access undertaking, including QR Network Access, QR National, other access holders, access seekers and end customers. A key reason for having an access undertaking is to provide all stakeholders with stability and certainty in their dealings and negotiations with one another during the period of the undertaking. Uncertainty will be introduced if the approved arrangements are continually subject to amendments, particularly unexpected amendments.

Such uncertainty could discourage new entrants into the rail haulage markets as well as new access seekers. The situation is exacerbated by the fact that, under the current QCA Act, only QR has the right to seek changes to agreed arrangements. The fact that access holders, access seekers and end users have no similar right to seek changes means the Authority is cautious about accepting amendments from QR without having regard to the wider operation of the access undertaking to date.

Given the time and effort that all parties put into the initial undertaking process, and the need to ensure that they address all issues openly with each other prior to final decisions being taken, a fundamental and substantial change in circumstances is likely to be required to justify compromising regulatory certainty by amending the undertaking part-way through its term. In this current case, QR is seeking to change a provision that QR itself initially proposed but that is not now working in QR's favour. Affected stakeholders do not unanimously or unequivocally support the proposal.

In contrast, stakeholders did support QR's recent Maintenance Cost DAAU, which sought a substantial rise in the provision for maintenance costs. The maintenance-cost claim had much more substantial implications for QR's commercial interests than does the current claim and was a response to changes in circumstances that were not entirely within QR's control. As a result, the Authority has indicated its support for changes to reference tariffs to reflect most of the increased maintenance costs claimed by QR.

In making its decision to preserve regulatory certainty by not accepting QR's CPI-adjustment application, the Authority notes that it may well be appropriate to review the arrangements relating to the system allowable revenues and revenue cap adjustments as part of the development of QR's next undertaking.

Way Forward

The Authority requests your response to the issues raised here by no later than **5:00pm on Thursday 29 November 2007**. A copy of this letter will be placed on the Authority's website, and other stakeholders will be given the same period as QR has been given to respond and provide any additional submissions on this matter.

Yours sincerely



Brian Parmenter
Chairperson