



Draft Decision

**QR's Draft Amending
Access Undertaking**

Coal System Maintenance Costs

September 2007

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SUBMISSIONS

This report is a draft only and is subject to revision. Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (the Authority). Therefore submissions are invited from interested parties concerning its assessment of QR's revised maintenance cost forecasts and reference tariffs for coal traffics in the central Queensland coal region. The Authority will take account of all submissions received.

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

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The **closing date** for submissions is 26 October 2007.

Confidentiality

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

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

Public access to submissions

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

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

PREAMBLE

On 3 May 2007, Queensland Rail (QR) submitted a voluntary draft amending access undertaking (DAAU) under s 142 of the *Queensland Competition Authority Act 1997* (QCA Act). In it, QR sought to revise its reference tariffs in the central Queensland coal region (CQCR) based on an increase in its maintenance allowance in 2007-08 and 2008-09.

The Authority published QR's proposal, invited interested parties to comment and issued QR with a notice of investigation under s 146 of the QCA Act.

Coal System Maintenance Cost DAAU

QR proposed revised reference tariffs in each of the CQCR systems for 2007-08 and 2008-09. The revised tariffs were calculated on the basis of increased maintenance allowances for those years.

The revised maintenance allowances were calculated by adjusting an 'efficient base' maintenance allowance for 2004-05 to take account of:

- increased costs due to higher volumes;
- higher than anticipated input cost increases for all maintenance activities; and
- increased costs associated with ballast undercutting activities.

QR did not undertake a detailed review of its maintenance activities – but committed to do so as part of the development of its next access undertaking.

The Authority's Assessment Process

Section 142(2) of the QCA Act requires the Authority to either approve or decline to approve a DAAU given to it.

In considering QR's proposal, the Authority focused on the criterion of efficient costs – that is, the Authority considers that QR should be compensated for costs and practices only to the extent that they are efficient. In this context, the Authority had regard to QR's objective of maximising coal supply chain efficiency and implementing a maintenance strategy that will achieve this in a commercially sustainable way.

The Authority's assessment of QR's proposal reflects the information that QR has provided and the circumstances under which it submitted its proposal – including QR's commitment to undertake a detailed review of its maintenance costs prior to submitting a replacement draft access undertaking in 2008. While the Authority shares stakeholders' disappointment that QR is seeking to review its reference tariffs so soon after they were approved in June 2006, it accepts that this is an issue of significant commercial concern for QR and needs to be dealt with in a timely manner.

On this basis, the Authority approached this assessment with the view to seeking a reasonable and fair interim solution, pending a future full-scale review of QR's maintenance allowance. The Authority notes that QR's current claims and the Authority's considerations of them should not form the basis for future evaluations – but should be recognised as an interim one-off solution.

Outline of Draft Decision

The Authority has accepted most, but not all, of QR's claims for increased maintenance expenditure. Unless the Authority approves all of QR's claims without amendment, the QCA Act requires that the Authority formally not approve QR's proposal and at the same time indicate to QR how its proposal should be amended in order for it to be approved. Hence, the Authority's draft decision is to not approve QR's proposal to revise the CQCR reference tariffs to reflect increased maintenance allowances in 2007-08 and 2008-09.

In arriving at its decision, the Authority considered submissions from interested parties, as well as QR's proposal and supporting claims. The Authority also engaged consultants, GHD Pty Ltd, to provide independent advice on technical aspects of QR's proposal.

In considering amendments to QR's maintenance allowance, the Authority focussed on the reasonableness of the costs in QR's proposal and the methodology applied in determining the costs and calculating reference tariffs.

QR's central proposal is to revise reference tariffs in 2007-08 and 2008-09 to reflect the increased maintenance cost forecasts for those years. QR argued that its currently approved maintenance cost forecasts are flawed – and grossly underestimate maintenance expenditures made to date. The cost increases have been driven in part by unanticipated input cost increases, network activity and changed maintenance practices, but also by an error in QR's business accounting system. QR considers that it cannot continue to absorb expenditures of this magnitude without compromising its underlying commercial position.

The Authority notes that stakeholders have raised a number of detailed and legitimate concerns about QR's proposal, including that QR has not adequately demonstrated that the proposed tariff increases are justified. One particular issue is whether QR should have been aware of the significant cost increases when it submitted its 2006 forecasts – and whether QR should bear some responsibility for submitting forecasts which failed to take account of information that QR should have known, or which contained fundamental errors. Another issue is whether the proposed amendments reflect actual impacts on the level of efficient costs and not simply changes in QR's expected actual costs.

The Authority has not sought to address these matters in this decision. Rather, it considers that they are better addressed as part of the detailed full-scale review proposed as part of the development of the next undertaking. The Authority notes QR's commitment to provide more information regarding its maintenance planning and decision-making, including a credible CQCR Network Maintenance Plan, at that time.

The Authority is satisfied that the efficient cost of maintenance has increased since QR originally developed its maintenance forecasts – and that, on balance, it is reasonable for QR to recoup some part of any unforeseen increase in efficient costs. The Authority notes that it is in the interests of service users, coal producers and the general public that QR continues to provide sufficient rail infrastructure capacity to meet the demands of coal producers and exporters.

The Authority accepts QR's revised allowance for 'other tasks' as these are broadly consistent with (albeit higher than) relevant industry benchmarks. However, the Authority does not accept QR's revised allowance for ballast undercutting as QR has not been able to demonstrate that it has acted prudently in dealing with the coal fouling issue. Hence, the Authority requires QR to revise its ballast claim and recalculate the relevant system allowable revenues and reference tariffs accordingly.

The Authority requires QR to revise the system allowable revenues included in the access undertaking to reflect the maintenance claim, adjusted for the revised ballast undercutting allowance. It also requires QR to backdate the amended reference tariffs and the 2007-08 system allowable revenue to 1 July 2007.

Way Forward

The Authority is aware that QR sought to have the amendments apply from 30 June 2007. This is clearly no longer possible and it is important that all stakeholders have the opportunity to comment on the Authority's draft decision.

If, following consideration of all submissions in response to the draft decision, the Authority confirms its decision to not approve QR's proposal, the Authority must issue QR with a notice stating its reasons for the refusal and its requirements about how QR should amend its proposal.

If QR submits an amended proposal, the Authority will consider it in accordance with the processes required under the QCA Act, including publishing the amended proposal and inviting comments on it.

Submissions

The Authority seeks submissions in relation to the draft decision. Submissions must be received by no later than 26 October 2007. The Authority will consider any submission it receives within that time.

The Authority advises that it will NOT take account of any material received after that date, irrespective of the author's identity or the circumstances of its lodgement.

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1. INTRODUCTION

QR's 2006 access undertaking came into effect on 30 June 2006. It sets out the terms and conditions under which QR will provide access to those parts of its rail infrastructure that are covered by the undertaking. This includes reference tariffs for coal-carrying services in the central Queensland coal region that are based on efficient costs, including maintenance costs.

QR has identified that the allowance for maintenance costs incorporated into reference tariffs was significantly below its actual cost of maintenance in 2005-06 and 2006-07 and is expected to remain significantly lower than the actual cost of maintenance for the remainder of the regulatory period.

Accordingly, QR has submitted a draft amending access undertaking (DAAU) to the Authority seeking to revise the allowance for maintenance costs for 2007-08 and 2008-09 and to incorporate revised reference tariffs for those years in its access undertaking. In doing so, QR has not sought to recoup any maintenance cost "shortfalls" to date, nor the additional costs of changes in its maintenance practices adopted to maintain service quality given higher throughput.

In accordance with the Queensland Competition Authority Act 1997, the Authority must consider a DAAU submitted to it for the purpose of amending an approved access undertaking and either approve, or refuse to approve, that DAAU.

1.1 Declaration of Third Party Access

In 1998, the use of rail transport infrastructure managed by QR was declared under Part 5 of the *Queensland Competition Authority Act 1997* (the QCA Act), and is therefore subject to the third party access provisions of the QCA Act. These provisions require QR to allow other train operators to use its intrastate rail infrastructure on agreed terms and conditions.

While Part 5 of the QCA Act imposes broad obligations on an access provider, it also provides for the development, and the Authority's approval, of an access undertaking. An access undertaking sets out the terms and conditions under which QR will provide access to the parts of its rail infrastructure that are covered by the undertaking.

Among other things, the access undertaking includes provisions that define the characteristics of the reference train and the associated reference tariffs for coal-carrying services on the central Queensland coal region (CQCR).

The reference tariffs consist of a number of parts, including an incremental maintenance charge (AT₁), capacity and allocative components (AT₂ - AT₄) and an electric access tariff (AT₅). The tariffs are derived to allow QR to recover the efficient costs of providing network services, including efficient maintenance costs.

QR's Approved Access Undertakings

The Authority approved QR's first access undertaking in December 2001 (the 2001 access undertaking), and then a replacement to this in June 2006 (the 2006 access undertaking). As approved, each undertaking included reference tariffs that incorporated estimates of efficient maintenance costs.

- For the 2001 access undertaking, the estimate of efficient maintenance costs for each system was determined following a detailed analysis of maintenance costs for QR and overseas rail systems. The estimates included an efficiency factor to take account of

QR's operational inefficiencies at that time and anticipated productivity improvements over the regulatory period.

- For the 2006 access undertaking, the Authority approved the estimate of maintenance costs submitted by QR but made adjustments to exclude costs attributable to non-coal traffic and to account for the approved volume forecasts. The estimates accepted by the Authority had no further efficiency factor built in. Apart from these adjustments, the Authority accepted QR's proposed maintenance allowance because it was reasonable in comparison to the approved allowance in earlier years.

In June 2007, the Authority approved a new regulatory regime for coal-carrying services in the CQCR. The new regime, and the amended access undertaking which put it into effect, provided for a hybrid revenue cap for coal-carrying services based on approved system allowable revenues, which in turn were constructed from estimates of efficient costs. Nevertheless, reference tariffs remain an important feature of the access undertaking to the extent that QR is required to apply a consistent access charge to all train services operating between a nominated cluster of origins and destinations (subject to differences in cost or risk) and to the extent that approved reference tariff components are passed through to end users within the above-rail rail haulage contract.

QR's current access undertaking will apply until 30 June 2009. However, aspects of it can be amended via provisions in the undertaking, or by QR or the Authority under the amending arrangements contained in the QCA Act.

In particular, s 142 of the QCA Act allows QR to voluntarily submit a DAAU to amend its approved access undertaking at anytime. Under these arrangements, the Authority is required to consider a DAAU given to it by QR and either approve, or refuse to approve, that DAAU.

1.2 QR's Draft Amending Access Undertaking

On 3 May 2007, QR submitted a DAAU to the Authority seeking to revise the maintenance cost forecasts for 2007-08 and 2008-09 and incorporate revised reference tariffs for those years.

In doing so, QR has argued that the maintenance cost forecasts incorporated into the 2006 access undertaking's reference tariffs were flawed – and grossly underestimated maintenance expenditures observed to date.

QR's UT2 maintenance allowance is significantly below the actual cost of maintenance in 2005-06 and is expected to remain significantly lower than the actual cost of maintenance throughout the period of UT2 ... By the end of 2006-07, QR will have already incurred maintenance costs estimated to be approximately \$52 million higher than its maintenance allowance in the first two years of UT2 and will expect to incur similar losses in the last two years of UT2 if revenues do not increase. (QR, sub. no. 1:7)

QR claimed that it cannot continue to absorb losses of this magnitude without compromising its underlying commercial position (QR, sub. no. 1:4).

QR constructed a revised provision for maintenance costs for 2007-08 and 2008-09 that is based on an 'efficient base' estimate of maintenance costs derived from the maintenance costs incorporated into reference tariffs by the Authority as part of QR's 2001 access undertaking. QR used the 2004-05 maintenance cost estimates as its base cost and adjusts this to account for volume changes, increased input costs and the increased cost of ballast undercutting. QR did not seek to recover any maintenance cost "shortfalls" for 2005-06 and 2006-07, nor the additional costs of changes in its maintenance practices adopted to maintain service quality in the face of higher throughput.

QR used the revised estimate of efficient maintenance costs to derive new reference tariffs for 2007-08 and 2008-09. In determining its revised reference tariffs, QR increased the incremental maintenance component of its reference tariffs (AT₁) by 10% to maintain the integrity of its past modelling approach. On this basis, QR will recover the majority of the increase in maintenance costs (non-electric) through the AT₂₋₄ reference tariff components. The increase associated with maintenance costs for electric assets has been recovered entirely through the electric access tariff (AT₅) in the Blackwater and Goonyella systems.

QR has also sought to amend a typographical error in Schedule F of its undertaking with respect to the AT₅ (electric access) reference tariff component in Central Goonyella.

1.3 The Authority's Considerations

Section 142 of the QCA Act requires the Authority to consider a DAAU submitted to it for the purpose of amending an approved access undertaking and either approve, or refuse to approve, that DAAU.

The Authority's assessment criteria for considering a DAAU are the same as for considering a draft access undertaking. That is, to approve a DAAU, the Authority must consider it appropriate to do so having regard to s 138(2) of the QCA Act and if it has complied with s 138(3) of the QCA Act.

Section 138(2) of the QCA Act states that 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;
- the interests of people who may seek access to the service; and
- any other matter the Authority considers relevant.

Under s 138(3) of the QCA Act, the Authority may approve a draft access undertaking only if it has published the undertaking and invited persons to make submissions and has considered submissions received.

1.4 The Authority's Assessment Process

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

In assessing QR's claims, the Authority adopted a 'top down' approach which focuses on the reasonableness of the inputs and quantum of costs QR is proposing. In doing so, the Authority reviewed QR's proposal and its supporting documents (including confidential information on the key cost drivers of maintenance activities) and had regard for the matters raised by stakeholders in their submissions in response to QR's proposal.

The Authority also engaged independent consultants, GHD Pty Ltd (GHD), to provide independent advice on certain technical aspects of QR's proposal. On this basis, GHD has prepared a report, which is available for download from the Authority's web site (<http://www.qca.org.au/rail/2006auammend/coalsysmaintcosts.php>).

2. ASSESSMENT OF QR'S PROPOSAL – MAINTENANCE CLAIM

QR has proposed a revised estimate of efficient maintenance costs that combines a re-estimated allowance for ballast undercutting with a roll-forward for other tasks for each coal system in the central Queensland coal region. The estimate of non-ballast maintenance costs has been calculated by QR escalating maintenance costs that had been deemed efficient by the Authority in past to reflect changes in QR's operating environment – i.e. it does not necessarily reflect actual information on the cost, type and frequency of maintenance activities performed by QR at this time.

The Authority assessed QR's proposal having regard for the views presented by stakeholders in submissions, advice it has received from GHD and its own analysis.

The Authority's assessment has been based on the criterion of efficient costs – that is, the Authority considers that QR should only be compensated for costs and practices to the extent that they are efficient. However, given the circumstances under which QR submitted its proposal and the type of information QR provided, the Authority considers that, at this time, it is most appropriate to adopt a broad approach to assessing QR's proposal, pending an extensive review in the future. On this basis, the Authority focused on the reasonableness of the inputs and quantum of costs and how these costs are then translated into reference tariffs.

The Authority adopted this approach in this instance with the view to seeking a reasonable and fair *interim* solution, pending a full-scale review of QR's maintenance costs as part of the next access undertaking.

The Authority considers that QR's proposed maintenance costs for tasks other than ballast undercutting are broadly consistent with other industry benchmarks, but it does not accept QR's revised rate for ballast undercutting and accordingly requires QR to adjust this element of its claim.

2.1 QR's Maintenance Claim

QR's Proposal

QR proposed revised maintenance costs for 2007-08 and 2008-09 based on maintenance costs that were approved by the Authority in 2001 that are then adjusted for increased volume forecasts, input cost escalations and a systemic change to the cost of ballast undercutting.

Using this approach QR proposed maintenance cost forecasts for 2007-08 and 2008-09 that are around \$20 million greater than those approved by the Authority in June 2006 – but are nevertheless around \$12 million below QR's revised forecasts based on its updated Network Maintenance Plan (NMP) (Table 1).

Table 1: Proposed Maintenance Allowance: 2007-08 and 2008-09 (\$million)

	2007-08	2008-09
2007 Network Maintenance Plan	111.4	115.9
Proposed Maintenance Costs	99.5	103.8
2006 Access Undertaking	77.9	84.2

QR, sub. no. 1:32

While QR did not undertake an extensive review of its maintenance activities, it expects that 'a detailed review of its maintenance costs will show that the true 'efficient cost' of operation is close to the latest 2007 NMP estimate' (QR, sub. no. 1:5).

QR did not seek to recover the cost "shortfalls" experienced in 2006-06 and 2006-07 nor the additional costs relating to changed maintenance practices.¹

Estimate Revised 'Efficient Base' Maintenance Costs

QR used the maintenance costs incorporated into 2004-05 reference tariffs as its base cost. These maintenance costs were approved by the Authority as part of its consideration and approval of QR's 2001 access undertaking. QR indicated that its base cost includes the 15% efficiency factor which was built into the maintenance cost forecasts over the 2001 regulatory period. QR argued that, as a result, this provides a 'benchmark for the efficient cost of maintaining the network as at 2004-05, given the 2004-05 forecast tonnage profile' (QR, sub. no. 1:8).

QR's efficient base maintenance costs exclude the cost of ballast undercutting from 'other tasks' (see below).

Roll Forward QR's Base Cost

QR adjusted, or rolled forward, the efficient base cost for 'other tasks' to take account of variations in volumes between the previous and current regulatory period and input cost escalations in excess of CPI.

To adjust the base cost for variations in volumes, QR used the relationship between gtk and maintenance costs that was specified in the Bovis Lend Lease Review (December 2004) and subsequently used by the Authority in its December 2005 Decision. That is, to increase maintenance costs by 40% of the proportional increase in volumes. For example, if volumes increase by 10%, maintenance costs would increase by 4%.

QR argued that this approach is 'broadly consistent with international rail experience' but that it expects that this assumption will be reviewed as part of a broader review of its maintenance costs as part of its next access undertaking (QR, sub. no. 1:9).

QR excluded the gtk's associated with the Hail Creek and Rolleston spur in Goonyella and Blackwater respectively to make this adjustment for volume variations. QR argued that the methodology is not applicable to these hauls – i.e. these hauls were not included in the 2004-05 forecast and were covered by a specific maintenance allowance in the 2006 access undertaking (QR, sub. no. 1:10).

QR then adjusted these estimates to account for the higher escalation of input costs that have resulted from the export coal boom and the expansion in mining activity in the CQCR. QR argued that, at the time the approved (2006 access undertaking) maintenance costs were developed, the full extent of the inflationary pressures now being experienced was not 'reasonably foreseeable' – so QR's key maintenance cost inputs have increased by more than what was anticipated at that time (QR, sub. no. 1:11).

¹ Since 2004-05, QR has implemented a number of changes to the way it undertakes certain key maintenance activities 'to maintain service quality in the face of a higher than anticipated level of track defects and higher anticipated throughput'. QR argues that neither the full scope, nor cost, of these changed maintenance practices were fully anticipated when the 2006 forecasts were being developed (QR, sub. no. 1:21).

QR adjusted the nominal maintenance cost estimate upwards by a further 10% to take into account input cost escalation above CPI growth in the CQCR between 2003-04 and 2005-06. This factor is based on a study commissioned by QR which was prepared by Booz Allen Hamilton (as seen in Appendix 1 of QR's submission). QR claimed that its proposed 10% increase may be 'conservative' given the results of another report prepared for QR on increases in wage costs in the mining sector and other reported increases in building cost indices (QR, sub. no. 1:13).²

At the same time, QR assumed that input cost escalation for the remainder of the current regulatory period will be in line with CPI growth. QR argued that this position 'is considered to be conservative' given the pressure on input costs are expected to continue for the remainder of the regulatory period (QR, sub. no. 1:13).

Ballast Undercutting Costs

Ballast undercutting accounted for almost 25% of QR maintenance spend in 2005-06 and is anticipated to remain the dominant individual maintenance activity for the remainder of the regulatory period (QR, sub. no. 1:14).

QR proposed a revised ballast undercutting allowance in 2007-08 and 2008-09. This revised allowance was based on a revised unit rate per kilometre for ballast undercutting which was multiplied by the average number of kilometres of ballast undercutting forecast for the entire regulatory period. QR argues that this is a 'more equitable alternative' than using the approved activity for those years, as using the forecast activity will bias the cost of maintenance in any one individual system (QR, sub. no. 1:15).

QR proposed a step increase in the unit rate of ballast undercutting from \$115,000 per km in December 2003 dollar terms to \$141,894 per km in June 2006 dollar terms. From June 2006 to the end of the undertaking, QR escalated this unit rate by assumed CPI growth of 2.5%.

QR's revised ballast undercutting allowance was then added to its revised efficient maintenance allowance which QR then presented as its revised maintenance allowance proposal for 2007-08 and 2008-09.

Quantum of Costs

In summary, QR has proposed a revised maintenance allowance for 2007-08 and 2008-09 – the allowance for 2005-06 and 2006-07 remains unchanged (Table 2).

² A report undertaken for QR by Hill and Associates indicated that the average wage costs in the mining sector (including on-costs and inducements) increased by between 35% and 40% in the 5 year period to 2005-06. Brisbane's building construction index rose by an annual average of 10 percentage points per annum above CPI growth between June 2003 and June 2006, resulting in the index being over 40% higher than the CPI index at the end of the period (QR, sub. no. 1:13).

Table 2: Proposed Revised Maintenance Costs (Nominal end of year \$million)

Nominal end of year \$million	2007-08		2008-09	
	Maintenance Allocation (excl Ballast)	Ballast Undercutting	Maintenance Allocation (excl Ballast)	Ballast Undercutting
Blackwater (excl Rolleston spur)	33.9	5.9	35.3	6.0
Goonyella (excl Hail Creek spur)	33.5	8.5	34.5	8.7
Moura	7.8	0.0	8.7	0.0
Newlands	6.6	1.2	6.8	1.2
Rolleston spur	0.9		1.5	
Hail Creek spur non electric	1.1		1.0	
Hail Creek spur electric	0.2		0.2	
Total	83.9	15.5	87.9	15.9

QR, sub. no. 1:14,16

Stakeholder Comments

The Authority received submissions on QR's proposal from the Queensland Resources Council (QRC) and Pacific National (PN).

The QRC considered that the lack of consultation undertaken by QR prior to submitting the DAAU and the limited information contained in it has meant that it is not in a position to provide meaningful input into key questions on QR's proposal (QRC, sub. no. 3:2).

Both stakeholders raised a number of concerns about QR's broad approach to revising maintenance cost forecasts. In particular, the QRC argued that QR's approach 'falls well short of the process of establishing efficient maintenance costs' which would normally be expected (QRC, sub. no. 3:7). While PN accepted that it was not practical to complete a full re-evaluation of efficient costs at this point in the regulatory cycle, it noted that care needs to be taken to avoid drawing incorrect conclusions from applying generalised factors to aggregate figures (PN, sub. no. 2:1).

That said, stakeholders agreed that the Authority should focus on efficient costs – and, to the extent that efficient costs have moved from the range envisaged in the 2006 forecasts, it might be appropriate to compensate QR for those changes. In addition, PN noted that, where QR has incurred additional costs in order to meet genuine customer demand, QR should be compensated for that (PN, sub. no. 2:1).

Estimate Revised 'Efficient Base' Maintenance Costs

PN and the QRC questioned the appropriateness of using the 2004-05 approved maintenance cost as a base for which to determine revised maintenance cost estimates in the subject years.

PN suggested that using the 2004-05 maintenance costs 'is unfortunate as it would have been conceptually better to have worked from the cost base that was actually considered by the QCA in some detail, explaining how the various factors have impacted on those costs' (PN, sub. no. 2:9). The QRC also found it 'challenging' to conclude that the 2006 estimates were so fundamentally flawed, given the 'rigorous process of review to which these forecasts were subject' (QRC, sub. no. 3:4).

A key concern was whether there were any discontinuities in the underlying assumptions between the 2001 access undertaking and 2006 estimates. In this regard, the QRC also queried the extent to which 2004-05 can be considered a 'typical' year of maintenance for the purpose of the roll-forward – and to what extent does it provide an indication of the expected maintenance task in 2007-08 and 2008-09.

Roll Forward QR's Base Cost

Both stakeholders raised concerns on a number of issues regarding the roll-forward of QR's base cost.

Neither PN nor the QRC accepted QR's claim that the observed maintenance cost increases could not have been reasonably anticipated. For example, PN noted that, at the time QR submitted its June 2006 proposal, it had already made some adjustments to reflect increased volumes and could be expected to have been aware of at least a substantial element of the problems besetting their estimate of maintenance costs (to the extent that this impacted on efficient costs).

At the very least, QR would have had the benefit of at least 9 months of the 2005/06 financial year results to understand that they were incurring costs approximately 38% above budget and some indication that this was not a temporary anomaly ... It would be most unusual for an organisation of the size and competence of QR to have engaged in an annual budgetary process without having due regard to current levels of expenditure (at that time) for all substantial activities. Thus again it would seem curious that QR's infrastructure maintenance managers had been unaware at that time of the expected level of activities and associated costs planned for the 2006/07 financial year. QR's submission indicates that by that time the modified maintenance practices were in place and the unit costs were well above the consumer price index (CPI) allowance and therefore the increased costs ought to have been apparent (PN, sub. no. 2:2).

The QRC noted that an important question was the extent to which QR ought to have been aware of the issue and whether it is appropriate that QR bear some responsibility for submitting an undertaking which failed to take account of information available to QR, or which contains fundamental errors (QRC, sub. no. 3:5).

While PN accepted that the impact of increased network activity may not have been 'fully understood' when the 2006 forecasts were approved, it could not support the component of QR's claim attributable to higher volumes. PN was particularly concerned that QR had not adequately demonstrated that it could confidently predict the effects of volume increases. For example, PN argued that the effects of increased volumes will take some time to show up as a significantly increased maintenance task – and insufficient time has elapsed for a real understanding of the effects of the increased traffic task to be gained (PN, sub. no. 2:5).

PN supported elements of QR's submission relating to increased costs and changes in maintenance practices. In this regard, PN accepted QR's claim that the resources boom and rising diesel fuel prices has led to an increase in input prices above CPI, but sought to only include this to the extent that this reflected a genuine output cost effect and took account of the ongoing requirement for efficiency (PN, sub. no. 2:4-5).

PN also accepted that QR has changed its maintenance practices to provide a greater level of track availability – i.e. that 'QR has genuinely attempted to improve service, to its cost'.

It is Pacific National's view that "efficient costs" need to be considered in context. The adoption of more expensive maintenance costs to provide a greater level of capacity, *ceteris paribus*, when such capacity is in high demand, is appropriate. It is therefore appropriate that efficient costs would incorporate such a practice where it is warranted (PN, sub. no. 2:6).

However, that support was qualified to the extent that QR's strategy was an appropriate 'medium term' response in a time constrained capacity – and a more efficient longer term solution will be available with suitable investment.

PN also argued that QR should only be compensated for abandoning efficiencies that it had previously expected if this was related to the move to different maintenance practices to provide additional capacity or if the previously planned efficiencies were in fact unrealistic (PN, sub. no. 2:8).

Ballast Undercutting Costs

Stakeholders did not comment in detail on QR's proposal for ballast undercutting costs. However, the QRC questioned whether the increased ballast cleaning costs reflected a failure by QR to perform this maintenance activity to a sufficient level previously – and which QR had already been compensated (QRC, sub. no. 3:8). PN noted that the cost of ballast cleaning is subject to a number of variables, including the location of suitable ballast material compared to the work site – and accepted the unit rate nominated by QR as a reasonable generalised unit rate for this activity (PN, sub. no. 2:10).

Consultant's Analysis

The Authority engaged GHD to provide independent advice on technical aspects of QR's proposal.

Estimate Revised 'Efficient Base' Maintenance Costs

GHD confirmed that, on reviewing documents that formed the basis of the 2001 and 2005 access undertaking decisions, 'QR has chosen the appropriate maintenance allowance for 2004/05' as the base for its proposal.

Roll Forward QR's Base Cost

GHD sought to answer key questions about the way that QR proposed to roll forward its base cost to account for increased traffic volumes and increased costs.

GHD confirmed that QR have not sought to establish the underlying relationship between maintenance cost and tonnage, but have instead accepted the relationship adopted by the Authority previously where costs were assumed to increase by 40% of the increase in tonnage by volume. Since traffic volumes have increased, so too will maintenance costs – although GHD suggested that, by adopting this methodology, QR had probably overestimated maintenance costs. GHD also noted that, while the general thrust of the data cannot be argued (there is a significantly higher tonnage in the current regulatory period), QR did not appear to have used the volume forecasts included in the approved undertaking. That said, the apparent difference was small.

GHD noted that, while there is no doubt that cost increases *for a given quantity of work* have been greater than CPI over the period 2003 to 2006, it is not clear whether the quantity (scope and delivery) was appropriate. However, issues regarding the quantity of work cannot be assessed without further analysis.

GHD confirmed that QR has relied on, and correctly applied, its commissioned study by Booz Allen Hamilton to escalate costs to reflect higher input costs. GHD noted that, in doing so, QR had chosen the lowest estimate of unit cost increases for the period 2003-06 (of the studies

reported, although QR's other independent report and other reported cost increases are not directly related to the rail industry).

GHD also noted that QR had not allowed for ongoing improvements including those bought about by capital investment, improved work methods and industrial relations reform. GHD concluded that it was appropriate to also apply an X-factor (in the range 0.5%-1%) within a CPI-X adjustment.

Ballast Undercutting Costs

GHD noted that some ballast cleaning would be required even if no coal fouling occurred, but raised a number of concerns regarding QR's apparent strategy to address coal contamination and the revised ballast forecasts. A key concern was that coal contamination had increased *despite* an ongoing program of ballast cleaning and that this contamination had created the need for an increased program of work.

Our enquiries have not revealed the exact nature of QR's attempts to optimise the problem of coal contamination. However it is inevitable that the current strategy will result in capacity constraints in the network as larger and more frequent possession windows are required for the remedial work. It is therefore imperative that a concerted effort be made to transparently address the issue, a strategy that has not been apparent to date. (p. 32)

GHD noted that, while some ballast cleaning might be expected, the proposed scope of ballast cleaning, in particular in the Goonyella system, was excessive, being approximately twice what would normally be expected.

GHD accepted unit costs would be rising as a result of the increased effort required to clean, or in some cases replace, the ballast and the claimed requirement to use shorter track possession windows. In addition, GHD noted that, under these circumstances, the unit cost would be greater than the unit cost that would have been required had QR sought to address and resolve this issue earlier.

Assessment of Proposed Maintenance Allocation (excluding Ballast Undercutting)

GHD benchmarked QR's proposed maintenance costs (excluding ballast undercutting and overhead power) with other Australian networks (Australian Rail Track Corporation (ARTC) and WestNet Rail). GHD argued that the WestNet Rail maintenance costs represented a lower limit for maintenance cost in the Queensland context.

In summary, GHD found that QR was displaying higher costs than comparable railways. In particular:

- the Blackwater and Goonyella systems have costs that broadly match the ARTC (the East West network) and WestNet on a per gtk basis but, given the higher task (more tonnes) on Blackwater and Goonyella, they are higher on a per kilometre basis; and
- the Moura and Newlands networks have higher unit costs (both per kilometre and per gtk) than WestNet or the ARTC (the East West network) which operate at around the same volume densities but are much more diverse.

Authority's Analysis and Draft Decision

The Authority notes stakeholders' proposals that its assessment should focus on efficient costs. While a detailed 'bottom up' evaluation of all factors making up QR's maintenance claim might provide greater insights, the Authority accepts that it would be inappropriate to undertake such a

review at this time. Accordingly, the Authority sought to determine the reasonableness of the quantum of costs QR has proposed, in the context of QR's proposed 'top down' approach. While the Authority is well aware of the limitations of analysis of this nature, it nevertheless notes GHD's statement that it should be possible to reconcile these approaches, by having particular regard to the specific 'cost drivers' that create variations from longer term trends.

The Authority accepts QR's revised allowance for 'other tasks' as these are broadly consistent (albeit higher) with other relevant industry benchmarks. However, the Authority does not accept QR's revised allowance for ballast undercutting as it is not satisfied that QR has acted prudently in dealing with the coal fouling issue.

Estimating Revised 'Efficient Base' Maintenance Costs

The Authority notes stakeholders' apparent concerns regarding QR's proposal to use the 2004-05 maintenance costs (approved in 2001) as its base cost, rather than the approved 2006 forecasts. However, at this time, given the apparent 'flaws' embedded in the approved 2006 forecasts, the Authority is satisfied that it is not ideal to use those estimates. Therefore, while not necessarily ideal, it is reasonable to adopt the 2004-05 estimate (approved in 2001) as a base.

The Authority is satisfied that QR has correctly calculated revised 'efficient base' maintenance costs. That is, the maintenance costs incorporated into 2004-05 reference tariffs approved by the Authority and which take account of the 15% efficiency factor that was applied over that regulatory period.

Rolling Forward QR's Base Cost

The Authority notes that QR rolled forward its base cost to reflect increased volume forecasts and higher input costs – but has some concerns regarding the justification provided by QR for rolling forward its costs and the methods used to do so.

The Authority notes that QR proposed to increase costs by 40% of the proportional increase in volume. The Authority accepts that this is broadly consistent with the approach adopted previously – but notes that it is likely to overestimate any underlying increase in costs, although the extent to which it does is not clear. In particular, applying a broad 'rule of thumb' might rely on relationships between cost drivers and efficient costs that are not appropriate in all circumstances. Rather, changed maintenance practices will change the relationship between maintenance cost and volume so understanding the relationship between costs and increased volumes can only be established dynamically over time by appropriately tracking maintenance costs for different tonnage levels.

The Authority notes that QR has proposed to adjust maintenance costs to account for unforeseen inflationary pressures, in particular those relating to labour, fuel, consumables and accommodation. QR argued that these key maintenance cost inputs increased above CPI between 2003-04 and 2005-06 and that the pressure on input costs is expected to continue for the remainder of the regulatory period.

The Authority notes that QR has relied on, and correctly applied, the cost index prepared by its consultant – and in doing so has appeared to choose a somewhat 'conservative' estimate of broad cost increases compared with QR's other independent report and other reported cost increases.

Assessment of Proposed Maintenance Allocation (excluding Ballast Undercutting)

The Authority agrees with stakeholders that, in many respects, QR's claims lack a level of rigour and analysis expected to demonstrate that the costs of efficiently maintaining the network have increased. This, at least in part, reflects the well-known limitations of adopting a 'top down' approach as a basis to revise the estimates – but also the approach QR has adopted in this case in particular.

Despite this, the Authority notes that QR's proposed maintenance allowance (excluding ballast undercutting) is *broadly consistent* with (albeit somewhat higher than) other relevant industry benchmarks.

On this basis, the Authority accepts QR's claims for maintenance costs (excluding ballast undercutting) as a reasonable interim solution, pending a full-scale review of QR's maintenance allowance in the next undertaking.

Ballast Undercutting Costs

The Authority does not accept QR's revised allowance for ballast undercutting as it is not satisfied at this time that QR has acted prudently in dealing with the coal fouling issue. In this regard, the Authority notes that problems associated with coal fouling exist elsewhere, but not to the extent apparent in CQCR and, in particular, the Goonyella system. In addition, while QR has identified this as a significant issue, it appears to have made little progress in establishing who is responsible and what could be done to address this problem.

This is of particular concern given that QR has been investigating the causes of coal fouling since the issue was originally raised as part of the development of its 2001 access undertaking, yet this still remains a significant issue. By QR's reckoning, if the issue was resolved today, ballast cleaning would still need to remain in place for 'five to seven years' due to the extent of coal contamination.

The Authority is aware that QR has sought to introduce changes to coal handling arrangements that seek to address coal contamination issues. However, despite this the Authority is still concerned about the severity of the problem (in particular in the Goonyella system) and its apparent persistence in the face of actions taken by QR. In this regard, the Authority notes that QR's continuing and escalating costs of addressing coal contamination (as well as environmental and social issues) are likely to fundamentally change the perceived benefits and costs of QR adopting alternative strategies. This provides further support that QR must, as a matter of some priority, evaluate alternatives to address this issue.

On the information before it, the Authority must question whether QR has done enough in the past to address this issue – or whether the current problem is the result of past failures and the proposed cost increases simply seek to shift these costs to industry.

Given these concerns, the Authority rejects QR's ballast claim.

There are a number of ways in which the Authority's difficulties with QR's claim could be addressed. For example, as the Authority has done previously, the net present value of cleaning system could be determined and deducted that from the asset value and an equivalent increase allowed in annual maintenance costs. Given the complexity of the issue and the difficulties of adopting such an approach within the regulatory period, the Authority does not propose to pursue this approach at this time.

As an alternative, the Authority has sought to maintain the approach QR used to construct its revised claim. In this way, the Authority requires that QR revise its ballast claim to provide QR

with the quantum of ballast undercutting implied by the 2006 access undertaking but to also take into account the subsequent increased cost (unit rates) of undertaking that task.

The Authority does not accept QR's proposal to use the average number of kilometres of ballast undercutting forecast for the entire regulatory period. The Authority accepts that QR may well have revised the projected scope of the ballast undercutting activity since the maintenance cost estimates were first approved. However, the Authority is not satisfied that using a revised scope, based on an average, better reflects an *efficient* scope of works. That is, the Authority does not believe that QR has made a case that an increase in ballast cleaning is efficient – even though an increase in ballast cleaning may now be necessary given past inaction on this matter.

Further, it is not clear that using an average amount is, as QR suggests, any 'more equitable' (Table 3).

Table 3: Scope of Work (Ballast Undercutting) (km)¹

	Forecast Scope of Activity		QR Proposal
	2007-08 ¹	2008-09	
Blackwater	41	26	40
Goonyella	50	75	57
Moura			
Newlands	10	0	8
Total	101	101	104

¹ QR has advised that the forecast scope of work (Goonyella and in total) in its submission (p. 16) was not correct.

While the Authority notes that the estimates of efficient unit costs will not be known until the full-scale review is undertaken, it accepts that it is likely that actual unit costs have increased.

However, at this time, the Authority is not satisfied that QR has demonstrated that the underlying drivers of the increases in the unit costs for ballast are sufficiently different to the drivers for other costs to warrant any further increase. On this basis, the Authority does not accept QR's claim for increases in unit costs beyond the cost of key inputs included in QR's claim for its other maintenance tasks. Instead, the Authority requires QR to escalate its ballast costs in a manner consistent with the method it used to adjust for the higher escalation of input costs for its other maintenance tasks.

The Authority proposes to require that QR adjust the 2005-06 unit rate implied by the 2006 access undertaking (i.e. \$115 000 in December 2003 dollars), in a manner that is consistent with the adjustments made to account for input costs increases proposed for other maintenance tasks. That is, adjust the unit rate in line with assumed CPI growth, but provide for a further 10% increase to take account of the increase in costs of key inputs.

On this basis, the Authority has calculated a revised ballast undercutting unit rate for 2007-08 and 2008-09 (Table 4). The revised rate is around 5% less than QR's proposed unit rate.

Table 4: Revised Ballast Undercutting Unit Rate (end of year nominal dollars)

	2007-08	2008-09
QR's proposal	149,078	152,805
Revised required rate	141,367	144,901

Together, the forecast scope of work and a reduced unit cost provides for a total ballast claim that is less than QR's proposal (by around \$1.3 million each year) but is still more than the existing ballast undercutting allowance (Table 5).

Table 5: Revised Ballast Undercutting Cost (Nominal end of year \$million)

	2007-08		2008-09	
	Implied revised cost	QR's proposal	Implied revised cost	QR's proposal
Blackwater	5.8	5.9	3.8	6.0
Goonyella	7.1	8.5	10.9	8.7
Moura	0	0	0	0
Newlands	1.4	1.2	0	1.2
Total	14.3	15.5	14.6	15.9

Revised Maintenance Claim (Including Ballast Undercutting)

The Authority accepts QR's proposed maintenance costs for tasks other than ballast undercutting, but requires QR to adjust its ballast undercutting claim.

On this basis, the Authority would accept a revised maintenance claim (including ballast undercutting) of \$98.2 million in 2007-08 and \$102.5 million in 2008-09 (Table 6). This reduces the additional maintenance allowance provided for (over and above the allowance approved in the 2006 access undertaking) by around 6% in 2007-08 and 7% in 2008-09.

Table 6: Revised Maintenance Costs: 2007-08 and 2008-09 (\$million)

	2007-08	2008-09
2007 Network Maintenance Plan	111.4	115.9
QR Proposed Maintenance Costs	99.5	103.8
Revised Costs	98.2	102.5
2006 Access Undertaking	77.9	84.2

The Authority notes that the revised costs are still significantly greater than the maintenance costs included in the 2006 access undertaking – and over the two years provides an additional \$38.6 million to QR.

Draft Decision 1

The Authority does not accept QR's maintenance claim.

The Authority requires QR to revise its ballast claim to provide for:

- **the quantum of ballast undercutting implied by the 2006 access undertaking for 2007-08 and 2008-09; and**
- **a revised unit rate which provides only for the input costs increases proposed for other maintenance tasks.**

3. ASSESSMENT OF QR'S PROPOSAL – UNDERTAKING AMENDMENTS

QR proposed a one-off increase in reference tariffs to take effect from 1 July 2007 in each of the systems to capture the additional revenue required to cover its proposed revised maintenance cost allowance. QR has not proposed equivalent amendments to its approved system allowable revenues.

The Authority has sought to ensure that any maintenance claim is appropriately translated into reference tariffs and system allowable revenues – i.e. that the proposed reference tariffs accurately reflect the revised annual revenue requirement based on revised maintenance cost estimates.

The Authority has satisfied itself that QR's financial model has generated reference tariffs that reflect QR's maintenance claim and its desire to maintain its past approach to modelling the incremental maintenance charge. However, as the Authority rejected QR's claim for ballast undercutting (see Chapter 2), it does not accept QR's proposed reference tariffs. In addition, the Authority requires QR amend its system allowable included in the access undertaking to reflect the Authority's revised ballast cost provision.

QR sought to have the new tariffs approved prior to 1 July 2007, but did not address the situation of what should happen should approval of their requested changes occur after 1 July 2007. To enable QR to obtain the full benefit of maintenance cost increases accepted by the Authority, the Authority requires that QR backdate the amended reference tariffs and the 2007-08 system allowable revenue to 1 July 2007.

3.1 QR's Revised Reference Tariffs

QR's access undertaking contains reference tariffs for coal-carrying train services on the CQCR. Reference tariffs are calculated in accordance with a set formula and are derived from QR's approved annual revenue requirement and volume forecasts. In particular, Schedule F of QR's access undertaking provides information relating to coal-carrying train services in the CQCR, including:

- the reference tariffs as at 1 July 2005 that are applicable for nominated reference train services on the Blackwater, Goonyella, Moura and Newlands systems;
- the system allowable revenue QR is entitled to earn over the relevant year; and
- the gross tonne kilometres (gtks) for coal services in each system over the relevant year.

QR's Proposal

QR's proposal provides for a one-off increase in reference tariffs effective from 1 July 2007 in each of the systems to capture the additional revenue required to cover its proposed revised maintenance cost estimates. QR argues that incorporating these higher maintenance costs will increase CQCR reference tariffs by approximately 4.6% (Table 7).

Table 7: Implied Percentage Change in Average Tariffs

	% Change in \$/NT
Blackwater	6.4
Goonyella	2.0
Moura	8.1
Newlands	4.9
Total	4.6

QR, sub. no. 1:17

Appendix 2 of QR's submission provides a detailed comparison of its proposed revised reference tariffs and the approved reference tariffs (escalated by CPI to July 2007). However, QR has not proposed equivalent amendments to the approved system allowable revenues to take into account the revenues associated with its revised reference tariffs.

Authority's Analysis and Draft Decision

In reviewing QR's proposed reference tariffs, the Authority has sought to ensure that any maintenance claim is appropriately translated into reference tariffs and system allowable revenues – i.e. that the reference tariffs accurately reflect the revised annual revenue requirement based on a revised maintenance allowance.

Reference Tariffs

On 23 May 2007, QR provided the Authority with a financial model which gave a more detailed derivation of QR's proposed reference tariffs for 2007-08 and 2008-09 – given QR's proposed revised maintenance costs.

QR's model presented the annual revenue requirement for the CQCR (for electric and non-electric assets) which included its proposed amended maintenance allowances for each of the four central Queensland coal systems as at July 2007.

In determining its revised reference tariffs, the Authority notes that, for the non-electric assets, QR has chosen to recover the majority of the increase in its annual revenue requirement through the AT_{2,4} reference tariff components. QR has proposed to increase the incremental maintenance component of its reference tariffs (AT₁) by 10% in order to maintain the integrity of the past modelling approach until a more detailed analysis is undertaken. In particular, QR sought to maintain the link between the original AT₁ calculations (the 2001 access undertaking) and the current tariffs.

The increase in the annual revenue requirement associated with maintenance costs for electric assets has been recovered entirely through the electric access tariff (AT₅) in the Blackwater and Goonyella systems.

On reviewing this information, the Authority is satisfied that the reference tariffs QR has proposed for 2007-08 and 2008-09 reflect QR's revised annual revenue requirement based on its revised maintenance cost estimates and its desire to preserve its past approach.

However, as noted above, the Authority has not accepted QR's proposed maintenance costs in their entirety (see Chapter 2). Accordingly, the Authority requires that QR recalculate the reference tariffs to account for the reduced ballast cost estimates.

In addition, the Authority notes that this approach is, at best, an interim solution to allow QR to recover the additional maintenance costs at this time. In this regard, the Authority notes that QR intends to undertake a full review of its maintenance costs for the next undertaking – that will seek to identify the ‘efficient’ cost level for each maintenance activity.

Draft Decision 2

The Authority does not accept QR's proposed revised reference tariffs.

The Authority requires QR to recalculate the reference tariffs to reflect the revised cost of ballast undercutting (see Draft Decision 1).

Central Goonyella Cluster – AT₅ Tariff

QR also submitted an addendum with its DAAU to amend a ‘typographical error’ in Schedule F of its undertaking with respect to the AT₅ reference tariff component in Central Goonyella (QR, sub. no. 1:33).

QR argued that the correct opening tariff for the Central Goonyella cluster should have been \$1.18 per EGTK at 1 July 2005 rather than the published \$1.00 per EGTK.

On reviewing QR's financial model, the Authority accepts that the correct AT₅ reference tariff component for Central Goonyella is, as QR has proposed, \$1.18 per EGTK. This is based on the regulated asset base and operating costs accepted by the Authority in June 2006.

The Authority notes that, currently, the system allowable revenues for Goonyella in 2006-07 include the revenues associated with the correct reference tariff (Section 6.4, Part B of Schedule F). This means that, while QR has been charging the incorrect rate, it would not, as it has suggested, ‘absorb’ the costs associated with this error – rather QR would, in effect, recover any ‘under-recovery’ it has incurred as a result of the error through the revenue cap adjustment provisions in its access undertaking.

QR has since recognised that this is the case but is not seeking to recover the shortfall in revenue that occurred. QR has therefore proposed to reduce the system allowable revenue for 2006-07 to ensure that it aligns with the (then) published AT₅ reference tariff component. In the interests of transparency, the access undertaking should be amended accordingly.

Draft Decision 3

The Authority accepts QR's proposed revised AT₅ reference tariff component in Central Goonyella – but requires QR to amend the system allowable revenue for Goonyella in 2006-07 to ensure this aligns with the previously published AT₅ reference tariff.

3.2 System Allowable Revenue

While QR's DAAU proposed amendments to the approved reference tariffs to reflect its proposed higher maintenance costs, it did not include equivalent amendments to the approved system allowable revenues. As a result, QR's DAAU would allow it to raise, but not retain the additional revenues.

The Authority accepts that, at the time of submitting this DAAU, QR's proposed Schedule F Amendment was the subject of consideration by the Authority. Therefore, in submitting this

DAAU, QR did so consistent with Schedule F provisions at that time. However, new regulatory arrangements and related Schedule F amendments have since been approved (June 2007). In particular, the 2006 access undertaking now also includes approved system allowable revenues for each individual coal system in the CQCR.

As the Authority has accepted an increase to the AT_{2.4} reference tariff components (but not necessarily of to the extent of QR's original proposal), it is necessary revise the system allowable revenues reported in the access undertaking.

If the system allowable revenues are not revised, and if expected volumes are met, the likely result of the annual revenue adjustment will be that QR's actual revenue will 'over recover' compared to system allowable revenue – which QR will then have to return to access seekers through reduced tariffs in future. This is clearly not consistent with the intention of QR's proposal to provide QR with greater revenue to offset increased maintenance costs.

Therefore, the Authority requires that QR amend the current system allowable revenues to reflect the amendments required above.

Draft Decision 4

The Authority requires that QR amend the approved system allowable revenues to reflect the revised maintenance costs accepted by the Authority (see Draft Decision 1).

Volume Forecasts

In making its assessment, the Authority has noted that the gtps for Blackwater included in QR's submission do not include the mainline gtps associated with coal-carrying services travelling from the Minerva mine to the Port of Gladstone (Gindie-Minerva line).

While the Authority accepts that this is consistent with Schedule F provisions at the time QR submitted this DAAU, it notes that, since then, new regulatory arrangements and related Schedule F amendments have since been approved (June 2007). In particular, the approved published gtps for Blackwater now include the mainline gtps associated with the Gindie-Minerva line.

On that basis, the Authority requires that QR ensure that, upon approval, the published volume forecasts reflect the current approved gtps – i.e. volumes in Blackwater should include the mainline gtps associated with coal-carrying services on the Gindie-Minerva line.

3.3 Effective date

QR's submission sought for the amendments and new reference tariffs to be approved by 1 July 2007. Given that QR only submitted its DAAU in May 2007, a decision by 1 July 2007 was never realistic, given the public consultation and assessments that the Authority has to make in considering that DAAU. Despite this, QR did not expressly raise the issue of 'backdating' reference tariffs in the event that approval was not forthcoming by 1 July 2007.

The Authority considers that it is appropriate that QR backdate reference tariffs (and associated system allowable revenues) to 1 July 2007. This will ensure that QR will generate the additional revenue it is seeking in the timeliest manner.

Draft Decision 5

The Authority requires that QR backdate the reference tariffs components (and associated system allowable revenue) to 1 July 2007.

LIST OF SUBMISSIONS

Organisation/Individual	Submission Number
Queensland Rail (QR)	1
Pacific National (PN)	2
Queensland Resources Council (QRC)	3