

QRC submission

Working together for a shared future

Submission in response to QR's Draft Amending Access
Undertaking (October 2007) – Ex-post Indexation Adjustment

Queensland Competition Authority
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Introduction

The Queensland Resources Council (QRC) is the peak representative organisation of the Queensland minerals and energy sector.

The Council's membership encompasses exploration, production, and processing companies, energy production and associated service companies. QRC works on behalf of members to ensure Queensland's resources are developed profitably and competitively, in a socially and environmentally sustainable way.

This submission has been developed in consultation with a QRC working group combined with comments from interested individual member companies.

QRC provides this submission in order for the Queensland Competition Authority to fulfil its statutory obligations, to assess the draft amending access undertaking (DAAU) submitted by Queensland Rail (QR) in relation to an ex-post indexation adjustment proposal. However, it is with a degree of frustration that QRC has been required to address this matter as QR Network Access (QRNA), in the view of the QRC, has failed to reasonably justify its proposal.

Moreover, QRC is concerned that the approach adopted by QRNA (direct applications of DAAU processes to the regulator without appropriate industry consultation) may have established a misconception within QRNA that it is appropriate to instigate such processes in any circumstance.

QRC considers that any approach which enables QRNA to accept certain risks during a regulatory period, retain benefits when outcomes favour QRNA, and seek adjustments when outcomes are adverse to QRNA, is clearly not the intention of the regulatory regime. In regard to this fundamental principle, QRC strongly advocates for the QCA to reject QRNA's proposal.

QRC notes that establishing such a precedent by approving any aspect of QR's DAAU would undermine the regulatory regime. This includes undermining confidence in established regulatory and legislative processes, removing the ability of access seekers and end-customers to undertake business with a degree of certainty and, more importantly, provide QRNA with an even greater incentive to seek ambit claims in the hope of a favourable financial outcome, regardless of the merits of its proposals.



→ **QRNA should withdraw this DAAU immediately**

QRC considers that QRNA should immediately seek to withdraw its DAAU. QRC considers this the appropriate response given the asymmetric nature of QRNA's approach, the uncertainty which arises from an apparently continual set of revisions to proposed and accepted risks and the consequential impact these matters have on above-rail operators, access seekers and end customers' ability to plan with any sense of certainty surrounding the costs and terms and conditions within a regulatory period.

→ **QRNA's actions suggest a pattern of behaviour**

QRC is again disappointed with the lack of consultation undertaken by QRNA prior to initiating this regulatory process. QRC maintains that the DAAU process being undertaken by QCA cannot be seen as any substitute for genuine engagement by QRNA with its customers.

QRC notes that the constructive processes recently undertaken by QRNA and QRC during the development of QR's Schedule F amendment proposal is an example of how QRNA *should* engage with its customers.

→ **An approved undertaking provides a 'safe harbour'**

An approved access undertaking is designed, amongst other things, to provide certainty between access seekers, end customers and the regulated services provider, in terms of contract terms and conditions and published reference tariffs (where provided) in order to provide assistance to the access negotiation process.

Fundamentally, the approval of an access undertaking by the regulator provides certainty to access seekers, end customers and the regulated services provider by providing a 'safe harbour' for these parties to undertake business with a degree of certainty during the period of the approved undertaking.

QRC considers that the routine use of the DAAU process by QRNA to seek to reverse unfavourable impacts of risks accepted under the approved undertaking fundamentally undermines the public interest. Confidence in the regulatory regime is essential. In particular, the certainty which reference tariffs provide in terms of cost information as the basis for negotiating prices for access seekers and the total cost of the transportation task for end customers during the regulatory period should not be undermined.

A continual incremental shifting of the approved allocation of risks during a regulatory period fundamentally limits the ability of access seekers and end customers to have sufficient certainty and confidence that their interests are protected within a regulatory period.

There are also consequences to competition in other markets which arise from uncertainty from the incremental shifting of the approved allocation of risks during a regulatory period.

→ **QR's DAAU – an inappropriate use of regulatory processes**

QRC notes that QRNA's regulatory regime was not intended to be based on an asymmetric intra-regulatory period cost pass-through approach – whereby a regulated service provider accepts certain risks at the commencement of the regulatory period, then regularly seeks adjustments when outcomes are adverse, yet retain benefits when circumstances are favourable, on a regular basis throughout the regulatory period.



In this regard, economic regulation is intended to provide certainty of revenues and prices, not a starting point for an iterative process regulatory gaming.

QRC understands that the duration of the undertaking seeks to provide certainty to QRNA in terms of the revenues it can recover and terms and conditions that it can offer without regulatory intervention. Nevertheless, QRC considers that this regulatory 'safe-harbour' also extends to providing certainty and stability to access seekers, stakeholders and end customers. Given this, QRC's position is that the use of DAAU processes should be reserved for situations which are in the combined best interest of QRNA, industry, access seekers and the regulator. QRC would also prefer to see QRNA instigate some process of genuine stakeholder engagement to identify this collective importance of an issue before a DAAU is prepared.

To do otherwise would only facilitate an approach which promotes the continuous shifting of approved revenues, terms and conditions, which are essentially approved within the regulatory 'safe harbour' to protect the interests of access seekers, industry and QRNA.

An approach of incrementally increasing QRNA's prices from previously approved efficient costs undermines the analysis and consultation which goes into establishing robust regulatory processes.

→ **Mis-alignment – “not appreciated”**

QRC notes that QRNA has not clearly stated that it was aware of the effects of the issue it considers as mis-alignment (between approved forecast revenues and actual CPI) in its submission.

Moreover it appears that the basis of “not appreciating” this issue reflects subsequent movements in CPI since QR's Schedule F Amendment was submitted and subsequently approved by the QCA, and QRNA's own assumptions surrounding the future profile of CPI in this regard.

It also appears that the basis of QRNA's argument is not that it was not aware, but rather not satisfied with the outcome. The numerous references to asymmetric impact of this matter are effectively based on the assumption of known outcomes – that is, the analysis provided in support of QRNA's proposal is based on observed outcomes.

→ **The risk is symmetrical**

QRC considers that the risk of variation of actual CPI from the forecast, in the absence of knowledge of the outcome, is symmetrical. That is, without knowing the answer the application of the current access undertaking in relation to forecast CPI variation from forecast (actual from forecast) applies symmetrically. Suggestions that asymmetry arises due to the cumulative impact of the variation (actual from forecast) is difficult to comprehend given that this cumulative impact would also apply symmetrically to parties over the regulatory period.

QRC notes that in past circumstances where QRNA has obtained financial gains due to unanticipated outcomes, QRNA has not sought to return these gains to industry on the basis of asymmetry. While QRC does not support this DAAU as a matter of principle, in the event that the QCA sought to approve QRNA's proposal any wind-fall gains from previous arrangements should be taken into account for consistency with QRNA's argument (including, underspending capital expenditure and reported maintenance costs during the first regulatory period).



→ **Ability to comment on the form of regulation processes**

QRC notes that the public consultation process on the form of regulation (Schedule F Amendment) provided sufficient detail and information as to how QRNA's proposal would operate and the extent to which revenues were to be derived from approved annual revenue requirements which were based on approved reference tariffs.

Consideration of the proposed operation and associated impacts, including system allowable revenue amounts, were clearly contained within QRNA's submitted Revised Schedule F Amendment (25 June 2007), which was subsequently approved by the QCA.

In relation to the approved system allowable revenues, QRC is unable to comment on their derivation other than note that QRNA accepted these revenues as appropriate (by means of inclusion within its Revised Schedule F Amendment) and is now effectively seeking to reopen them in October 2007.

→ **Risk**

QRC notes that QRNA's approach of seeking to remove risks to which it is exposed fundamentally alters the risk allocation, and corresponding reward, regime. Further, there are concerns that QRNA's risk aversion, reflected by its DAAU in this instance, be considered in terms of its overall systematic risk.

Of particular concern is that QRNA's proposal could establish a precedent with which to reopen a number of other parameters, such as those relating to the approved cost of capital, during the remainder of the current regulatory period. Clearly, such an approach would give rise to greater uncertainty for access seekers and industry.

It is becoming increasingly difficult to identify to what actual risks QRNA is exposed, given their guaranteed (commercial) rate of return. QRNA's incremental efforts to remove the commercial risks, for which they are rewarded, is emerging as an important industry concern. For example, recent QRNA processes have provided for, or sought to establish, the transfer of:

- Capital expenditure risk (including optimisation of scope) – by means of the masterplanning process;
- Volume risk – by means of the 'form of regulation' process;
- Forecasting risk – reflecting errors within its 2006 maintenance costs; and
- Imprecision risk – reflecting errors in approved reference tariffs and system allowable revenues.

→ **Operational relevance**

It is difficult to understand how QRNA's DAAU is justified in terms of the actual impact on QRNA's operations. While the approval of QRNA's DAAU would result in greater revenue to QRNA, the extent to which this matter affects the performance of QRNA's network or service delivery has not been provided in QRNA's submission.



→ **Correcting the mis-alignment**

Ironically, if the mis-alignment (between actual and forecast CPI) is causing so much concern to QRNA, it is equally the case that the relevant reference tariff components could be escalated based on the forecast CPI which would satisfy its concern. That is, rather than adjusting the system allowable revenues, tariffs could be escalated by the approved CPI forecast which would remove any of QRNA's concern surrounding the mis-alignment between forecast and actual CPI.

→ **Accountability through transparency**

QRC considers that more needs to be done to improve accountability within QR's Access Undertaking. It is becoming apparent that QRNA has sought to remove accountability by instigating regulatory processes as the primary means to justify proposals. QRC would prefer to see QRNA encouraged to adopt a more commercial approach of taking reasonable responsibility for their key outcomes.

To this end, QRC would support QCA proposals which provide for greater disclosure of information and methodologies used by QRNA.