QUEENSLAND
COMPETITION
AUTHORITY

Final Decision

Aurizon Network's Revenue Cap Adjustment 2011-12

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1. AURIZON NETWORK REVENUE CAP ADJUSTMENT 2011-12

1.1 Background

On 28 September 2012, Aurizon Network submitted a revenue cap adjustment application, proposing to recover a revenue shortfall it experienced in 2011-12. Aurizon Network estimated the revenue cap adjustment to be a $13.9 million shortfall, and proposed to recover this amount via adjustment to the reference tariffs for 2013-14.

Aurizon Network's 2010 access undertaking provides for Aurizon Network to seek the Authority's approval to adjust a subsequent year's revenue cap, to account for under- or over-recovery of approved system allowable revenue amounts for each coal system in relation to:

(a) non-electric revenues (AT_{2-4} revenue adjustment amounts); and

(b) electric revenues (AT_5 revenue adjustment amounts).

The revenue capping mechanism in the 2010 undertaking differs from that in the 2008 undertaking as the tariff adjustments now occur as part of a separate process (i.e. the annual review of reference tariffs) that also takes into account revised volume forecasts, amongst other things. This process will be considered by the Authority prior to the start of the 2013-14 financial year.

In accordance with Aurizon Network's access undertaking, the Authority published Aurizon Network's proposal, invited stakeholders to comment and provided Aurizon Network with an opportunity to respond to those comments. The Authority received submissions from the Queensland Resources Council (QRC), Vale Australia, and Asciano Limited.

1.2 Aurizon Network's Proposal

Aurizon Network's estimated revenue shortfall in 2011-12 of $13.9 million comprises:

(a) a $2.7 million shortfall in relation to non-electric assets – comprised of a $9.1 million shortfall for the Blackwater and Newlands systems, offset by a $6.5 million net over-recovery for the Goonyella and Moura systems for the AT_{2-4} (i.e. non-electric) access charge revenues; and

(b) an $11.2 million shortfall in relation to electric assets (AT_5 reference tariff component), comprised of a $2.4 million over-recovery in the Blackwater system, offset by a shortfall of $13.6 million in the Goonyella system.

On this basis, Aurizon Network proposed a total revenue cap adjustment amount for 2011-12 of $13.9 million for the Authority's approval (see **Table 1** for details).

Table 1: Revenue adjustment amounts 2011-12 ($m)

System	*Non-Electric Revenues*	*Electric Revenues*	*Total Adjustment Amount 2011-12* #
Blackwater	($6.27)	$2.44	($3.82)
Goonyella	$2.20	($13.66)	($11.46)
Moura	$4.27	0	$4.27
Newlands	($2.87)	0	($2.87)
Total Adjustment Amount	($2.67)	($11.22)	($13.89)

 # excludes return on capital:

Aurizon Network calculated this shortfall by subtracting its 'actual' revenues ($690.9 million) from its 'adjusted' approved 2011-12 revenues ($704.8 million). Aurizon Network's 'actual' revenues are based on what Aurizon Network was entitled to earn regardless of whether or not it collected this amount, including revenues associated with reference train services, non-reference train services, take-or-pay obligations and other revenues which it was required to refund (but did not refund).

More specifically, Aurizon Network calculated its 2011-12 revenues on the basis that the:

(a) 'adjusted 2011-12 revenues' are the revenue caps approved by the Authority and adjusted (where necessary) to take account of:

- (i) the maintenance costs of maintaining branch lines for new loading facilities;
- (ii) actual maintenance cost escalation – using the actual, rather than forecast, maintenance cost index (MCI) to escalate the Authority's approved maintenance cost allowance;
- (iii) actual operating cost escalation – using the actual, rather than forecast, consumer price index (CPI) to escalate the Authority's approved operating cost allowance; and
- (iv) components relating to the recovery of Aurizon Network's cost of electric energy for traction costs associated with the connection of Aurizon Network's electric traction system to an electricity transmission or distribution network (adjusted to reflect the difference between actual and forecast costs);

(b) actual revenues are based on what Aurizon Network was entitled to earn, including revenues associated with:

- (i) reference train services;
- (ii) non-reference train services;
- (iii) transfer fees and rebates; and
- (iv) other revenues which it was required to refund (but did not refund).

1.3 Stakeholders' Comments

As in previous years, submissions from stakeholders generally focussed on concerns regarding a perceived lack of publicly available information to support Aurizon Network's revenue cap adjustment proposal and, in particular, the lack of consistency of the available information from year to year, which thereby makes it difficult for customers and other stakeholders to assess the proposal properly and make meaningful year-on-year comparisons.

The issue of transparency of the available information was also stressed by QRC as it feels constrained in its ability to assess the revenue cap on its own and verify the information provided by Aurizon Network.

For these reasons, all stakeholders pointed to the importance of the Authority's role in verifying the information provided to it by Aurizon Network before making any decision to approve the application.

Stakeholders also raised some issues regarding the nature of the revenue cap adjustment, and associated reference tariff adjustment, processes, particularly the low risks faced by Aurizon Network under the revenue cap form of regulation and issues relating to concerns with forecasting.

With regard to the latter, Vale and Asciano specifically pointed to concerns with the reliability and alleged lack of transparency of Aurizon Network's railings forecasts methodology, given the potential impact of variances on the size of subsequent reference tariffs adjustments.

While Asciano acknowledged that forecasting in general is problematic, it also said that increased consultation with miners and users of the network would likely improve forecasts and would reduce levels of 'tariff fluctuations'. Asciano pointed to the impacts of the revenue cap adjustments to future tariffs, and the need for rigour in ensuring there are no socialising of price adjustments over a broader range of tariffs than those that individual adjustment amounts relate to.

These process-related issues will be considered as part of the approval process for Aurizon Network's next access undertaking.

QRC also noted that Aurizon Network has indicated it will separately seek to recover an amount relating to a transfer of entitlements between the Barney Point and RG Tanna terminals 'via a separate correspondence to the QCA' and requested that the Authority ensure that appropriate consultation with stakeholders occur in relation to any such proposal. The Authority has noted QRC's request in this regard.

In its response submission, Aurizon Network acknowledged stakeholders' concerns, but did not provide any additional material that would address the concerns raised.

1.4 Assessment Criteria

Aurizon Network's 2010 access undertaking provides for the Authority to approve its proposed revenue cap adjustment amounts if it is satisfied that Aurizon Network has correctly calculated the extent of any under- or over-recovery of its total actual revenues compared with its adjusted revenue caps, where the adjustments to the revenue caps are in accordance with the Authority approved:

(a) actual maintenance cost escalation – using the actual, rather than forecast, MCI to escalate the Authority approved maintenance cost allowance;

(b) actual operating cost escalation – using the actual, rather than forecast, CPI to escalate the Authority approved operating cost allowance; and

(c) components relating to the recovery of Aurizon Network's cost of electric energy for traction costs associated with the connection of Aurizon Network's electric traction system to an electricity transmission or distribution network (adjusted to reflect the difference between actual and forecast costs).

In addition, the Authority can vary the revenue cap adjustment amounts in relation to:

(a) an increment – for the portion of over-recovery that Aurizon Network is reasonably entitled to retain for productivity improvements (not exceeding 2% of the approved revenues for that system); and

(b) 'QR cause' – for revenues which Aurizon Network earned, but which the Authority reasonably determines it was not entitled to due to its own breach of an access agreement or negligence, provided that the breach or negligence resulted in the non-provision of at least 10% of total train services in an access agreement in any given month.

In reviewing Aurizon Network's proposed revenue cap adjustment, the Authority sought to ensure that Aurizon Network had correctly calculated its claimed revenue under-recovery. Also, and as provided for in the undertaking, the review focused on the revenues that Aurizon Network was entitled to earn less any required deductions, whether or not it actually collected/refunded this amount.

1.5 Assessment of Aurizon Network's Proposal

Aurizon Network's proposed adjusted revenue caps and total actual revenues by coal system and by non-electric and electric assets are set out in **Table 2.**

Table 2: System Allowable Revenues against Total Actual Revenues ($m)

	Approved Revenue Caps	*MCI + CPI Adjustments*	*Energy and Connection Charges Adjustments*	***Total Adjusted System Allowable Revenues***	*Reference tariff revenues (Actual)*	*Other non-specific Train Services (Cross System)*	*Take or Pay Adjustments*	*Rebates*	***Total Actual Revenues***
Non-electric Revenues (AT_{2-4}) ($m)									
Blackwater	235.83	(0.15)	-	**235.68**	205.06	6.32	22.28	(4.24)	**229.42**
Goonyella	253.69	(0.18)	-	**253.51**	185.59	11.98	55.93	2.21	**255.71**
Moura	39.99	(0.03)	-	**39.95**	44.22	-	-	-	**44.22**
Newlands	25.17	(0.03)	-	**25.14**	19.03	0.49	2.69	0.07	**22.27**
Sub-total	554.68	(0.40)	-	**554.28**	453.89	18.78	80.90	(1.96)	**551.61**
Electric Revenues (AT_5) ($m)									
Blackwater	74.40	(0.01)	2.69	**77.08**	71.97	7.55	-	-	**79.52**
Goonyella	77.50	(0.01)	(3.97)	**73.52**	57.64	1.93	-	0.28	**59.85**
Sub-total	151.90	(0.02)	(1.29)	**150.59**	129.61	9.48	-	0.28	**139.37**
Totals	706.58	(0.42)	(1.29)	**704.88**	583.50	28.26	80.90	(1.68)	**690.99**

#Totals may vary due to rounding.

While Aurizon Network experienced an over-recovery in the Goonyella, Moura and Blackwater systems' revenue caps, it has not sought to retain any of the additional revenues in these systems as an 'increment'.

In addition, Aurizon Network advised it was not aware of any breaches of an access agreement or negligence by Aurizon Network that would give rise to a deduction from the revenue cap adjustment sought.

Adjusted Revenue Cap Amounts

Aurizon Network did not make any adjustment in relation to maintenance costs for new branch lines, but did adjust the approved revenue caps to account for:

(a) an actual MCI increase of 2.4% (compared to the forecast of 3.5% used in the approved revenue caps), with a cumulative increase over three years of 11.6% compared to forecasts of 11.8%, less the approved x-factor, resulting in a net decrease of $0.31 million;

(b) an actual CPI increase to June 2012 of 0.92% (compared to the forecast of 2.5% used in the approved revenue caps), with a cumulative increase over three years of 8.2% compared to forecasts of 8.4%, less the approved x-factor, resulting in a net decrease of $0.106 million; and

(c) an actual cost of $77.1 million for electric energy and traction costs – compared with $78.4 million, resulting in a net decrease of $1.3 million.

In reviewing these estimates, the Authority confirmed that Aurizon Network calculated the MCI and CPI using Australian Bureau of Statistics (ABS) published data for the relevant indices and the Authority's approved maintenance and operating allowance schedule.

Total Actual Revenues

In considering Aurizon Network's application, the Authority independently verified information that Aurizon Network sourced from the Aurizon above-rail business. The Authority also verified that Aurizon Network had appropriately applied the methodologies in the access undertaking, the relevant standard access agreement or its access agreements with the above-rail business. In this regard, the Authority notes that:

(a) *reference tariff revenues* – were accurately estimated based on:

(i) the approved reference tariffs; and

(ii) actual railings (i.e. tonnages and origin/destination) independently confirmed by a large sample of the customers (mining companies).

In assessing Aurizon Network's claims, the Authority has confirmed that the proposal has been calculated in accordance with the relevant provisions in the undertaking, in that Aurizon Network has correctly identified the extent of the under-recovery of its approved revenues (i.e. the last column of **Table 1**), including:

(i) using accurate actual railing information – Aurizon Network's railing information has been verified by the coal companies. The railings Aurizon Network used to calculate its revenues and that provided by a sampling of coal companies were assessed as consistent for the 2011-12 year; and

(ii) appropriately calculating the take-or-pay revenues – Aurizon Network has relied on correct information for actual railings and contracted train paths and has used the formula specified in the relevant standard access agreements to calculate the revenue amounts.

(b) *non-reference tariff revenues* – were accurately estimated based on:

(i) the use of appropriate reference tariffs of the closest existing relevant cluster; and

(ii) the approach previously applied and approved by the Authority in terms of allocating revenue between central Queensland coal region (CQCR) and non-CQCR systems where necessary.

In assessing Aurizon Network's claims, the Authority verified that the non-reference train services referred to in the submission consisted primarily of relevant cross-system train services and transfer fees totalling $28.3 million, for which revenues are allocated in accordance with the relevant principles in the undertaking, such that:

(i) access revenues for these traffics, based on negotiated tariffs, are consistently treated in the calculation of contribution to common costs and allocated to the relevant coal systems; and that

(ii) access revenues based on the nominated reference tariffs (for the Lake Vermont and Gregory mines) are allocated between systems in accordance with the appropriate methodology.

(c) *take-or-pay revenues and rebates* – were accurately estimated based on:

(i) actual railings and contractual commitments in access agreements, any cancellations due to 'QR Cause' and consist information;

(ii) the formulae in the 2001, 2006 and 2010 access undertaking standard access agreements – noting that, consistent with the earlier applications, Aurizon Network made no claims for take-or-pay revenue from pre-2001 agreements; and

(iii) consistency with the Authority's approach for determining rebate amounts payable against modelling provided by Aurizon Network.

As with 2010-11, higher than normal take-or-pay amounts were expected for 2011-12 as a result of haulage shortfalls due to ongoing depressed global market conditions, as well as some ongoing after-effects of the 2010-11 central Queensland floods, which affected rail operations and coal availability. Take-or-pay arrangements in all systems except Moura were triggered, with total take-or-pay revenues for the non-electric systems amounting to $80.9 million. In Moura, the shortfall was not sufficient to trigger take-or-pay.

The Authority has verified, through Aurizon Network's supplied data and modelling, that it has applied a consistent approach to determining the take-or-pay amounts, specifically that:

(a) railings within a nominated month, for the purposes of annual and variable take-or-pay, were consistently treated and consistent with previous years' treatment; and

(b) rebates for other mines, that are payable irrespective of whether take-or-pay is triggered, have been determined separately.

The take-or-pay arrangements provide for Aurizon Network to recover revenue from access holders where contracted services do not run. Where an above-rail operator does not utilise the entire amount of its contracted capacity (train services), it may be contractually obliged to make some payment in lieu of not doing so (take-or-pay charges).

The principle behind the capping mechanism under both the 2006 and 2010 access undertakings (UT2 and UT3 respectively) is that any surplus above system allowable revenues should be returned to access holders. However, the provisions detailing the methodology for capping what is returned or recovered from access holders under take-or-pay differs between these access agreements and has been at issue since the 2010-11 revenue cap determination.

In assessing the 2011-12 revenue cap adjustment application, the Authority is aware that an existing dispute between Aurizon Network and one of its stakeholders on the correct mechanism for applying the cap to UT3 take-or-pay arrangements, particularly with regard to how rebate variations should be applied to the take-or-pay arrangements, remains unresolved. However, no similar dispute has arisen this year and so the issue of the appropriate rebate arrangements associated with take-or-pay requirements was not raised in submissions on the 2010-11 revenue cap adjustment application.

Aurizon Network also indicated in its submission that it has calculated the billed take-or-pay on a different basis to the revenue cap take-or-pay, to allow for the transfer of entitlements between RG Tanna (RGT) and Barney Point Coal Terminal (BPCT). As noted earlier, Aurizon Network indicated that it will seek to recover the difference between revenue cap take-or-pay and the billed take-or-pay as an adjustment to allowable revenue via separate application to the Authority (which has not been received at this time).

While there remain inconsistencies on the treatment of the capping mechanism between the different types of standard access agreements, the Authority will continue to assess QR Network's approach and any deviation from the existing application or approaches from its current undertaking. However, the Authority notes that most stakeholders agree that any substantive changes to these processes, especially where there would be impacts on existing agreements and contracts, should be addressed as part of the next undertaking (UT4) approval process.