QUEENSLAND COMPETITION AUTHORITY

Final Decision

QR Network Revenue Cap Adjustment 2010-11

June 2012

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The Authority wishes to acknowledge the contribution of the following staff to this report

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1.1 Background

QR Network's 2010 access undertaking provides for QR 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 (AT2-4 revenue adjustment amounts); and

(b) electric revenues (AT5 revenue adjustment amounts).

On 30 September 2011, QR Network submitted its revenue cap adjustment application, proposing to recover a revenue shortfall it experienced in 2010-11. QR Network estimated the revenue cap adjustment to be a $49.2 million shortfall, and proposed to recover this amount via adjustment to the reference tariffs for 2012-13.

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

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 2012-13 financial year.

1.2 QR Network's Proposal

QR Network's estimated revenue shortfall in 2010-11 of $49.2 million comprises:

(a) a $19.2 million shortfall in relation to non-electric assets – comprised of a $21.8 million shortfall for the Blackwater, Moura and Newlands systems, offset by a $2.6 million net over-return for the Goonyella system for the AT2-4 (i.e. non-electric) access charge revenues; and

(b) a $30 million shortfall in relation to electric assets (AT5 reference tariff component).

On this basis, QR Network proposed a total revenue cap adjustment amount in 2010-11 of $49.2 million for the Authority's approval (see **Table 1** for details).

Table 1 – Revenue adjustment amounts 2010-11 ($m)

System	*Non-Electric Revenues*	*Electric Revenues*	*Total Adjustment Amount 2010-11*
Blackwater	(18.86)	(20.27)	(39.13)
Goonyella	2.58	(9.68)	(7.09)
Moura	(0.28)	0	(0.28)
Newlands	(2.67)	0	(2.67)
Total Adjustment Amount	(19.22)	(29.95)	(49.17)

QR Network calculated this shortfall by subtracting its 'actual' revenues ($637.4 million) from its 'adjusted' approved 2010-11 revenues ($686.6 million). QR Network's 'actual' revenues are based on what QR 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, QR Network calculated its 2010-11 revenues on the basis that the:

(a) 'adjusted 2010-11 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 QR Network's cost of electric energy for traction costs associated with the connection of QR 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 QR 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

The primary issue raised in the submissions from both Asciano and QRC relates to the different capping arrangements for take-or-pay amounts that apply to access agreements entered into in accordance with the provisions of the 2006 (UT2) and 2010 (UT3) approved access undertakings.

Asciano and QRC expressed concerns that the different capping arrangements have the potential to lead to inequitable outcomes when strictly applied as part of the revenue cap review process.

At the same time, these stakeholders acknowledged that any departure from the strict application of the capping arrangements applying to existing access agreements would require negotiation with, and agreement from, current access holders and may result in outcomes that differ from the intent of existing contracts. QRC noted, in this context, that forcing amendments to existing contracts would not be an intended or acceptable approach.

Stakeholders also noted that any solution to this issue would likely require changes to the approved 2010 access undertaking, and thus could not be achieved as part of this current revenue cap adjustment process.

QR Network acknowledged stakeholders' concerns with regard to this issue, but did not formally provide any additional material in response to the submissions.

1.4 Assessment Criteria

QR Network's 2010 access undertaking provides for the Authority to approve QR Network's proposed revenue cap adjustment amounts if it is satisfied that QR 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 QR Network's cost of electric energy for traction costs associated with the connection of QR 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 QR 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 QR 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 QR Network's proposed revenue cap adjustment, the Authority sought to ensure that QR Network had correctly calculated its claimed revenue under-recovery. Also, and as provided for in the undertaking, the review focused on the revenues that QR Network was entitled to earn less any required deductions, whether or not it actually collected/refunded this amount.

1.5 Assessment of QR Network's Proposal

QR 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}) ($m)									
Blackwater	212.96	1.38	-	**214.34**	158.61	7.63	19.96	9.29	**195.48**
Goonyella	235.73	1.59	-	**237.32**	178.90	12.56	43.80	4.64	**239.91**
Moura	42.82	0.28	-	**43.10**	29.48	-	13.34	-	**42.82**
Newlands	32.26	0.25	-	**32.52**	29.09	0.65	-	0.11	**29.85**
Sub-total	523.77	3.51	-	**527.28**	396.07	20.84	77.10	14.05	**508.05**
Electric Revenues (AT_5) ($M)									
Blackwater	84.45	0.08	(0.80)	**83.73**	57.78	5.68	-	-	**63.46**
Goonyella	79.89	0.11	(4.39)	**75.62**	62.32	2.89	-	0.72	**65.94**
Sub-total	164.34	0.19	(5.19)	**159.35**	120.10	8.57	-	0.72	**129.40**
Totals	688.12	3.70	(5.19)	**686.63**	516.18	29.41	77.10	14.77	**637.45**

 # Totals may vary due to rounding

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

Adjusted Revenue Cap Amounts

QR 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 3.6% (compared to the forecast of 2.7% used in the approved revenue caps), with a cumulative increase over two years of 9.6% compared to forecasts of 7.7%, less the approved x-factor, resulting in a net increase of $2.84 million;

(b) an actual CPI increase of 3.8% (compared to the forecast of 2.5% used in the approved revenue caps), with a cumulative increase over two years of 7% compared to forecasts of 5%, less the approved x-factor, resulting in a net increase of $0.84 million; and

(c) an actual cost of $65.8 million for electric energy and traction costs – compared with $71 million, resulting in a net decrease of $5.2 million.

In reviewing these estimates, the Authority confirmed that QR 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 QR Network's application, the Authority independently verified information that QR Network sourced from QR National Coal. The Authority also verified that QR Network had appropriately applied the methodologies in the access undertaking, the relevant standard access agreement or its access agreements with QR National. 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);

(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;

(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 and 2006 access undertaking standard access agreements – noting that, consistent with the earlier agreements, QR Network made no claims for take-or-pay revenue from pre-2001 agreements;

 (iii) QR Network's interpretation of the formulae in the 2010 access undertaking standard access agreements, with the knowledge that there is an outstanding dispute relating to this interpretation; and

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

Reference Tariff Revenues

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

(a) using accurate actual railing information – QR Network's railing information has been verified by the coal companies. The railings QR Network used to calculate its revenues and that provided by the coal companies were consistent for the 2010-11 year (variation of less than 2%); and

(b) appropriately calculating the take-or-pay revenues – QR 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.

Take or Pay and Access Agreements

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 take-or-pay arrangements provide for QR Network to recover revenue from access holders where contracted services do not run. This arrangement does not apply where QR Network is unable to make rail infrastructure available for the operation of train services in accordance with an access holder's train service entitlement, i.e. where the service does not run because of a QR cause.

In 2010-11, take-or-pay was triggered in all systems except Newlands, taking the total take-or-pay revenues to $77.1 million. Higher than normal take-or-pay amounts were expected for 2010-11 as a result of haulage shortfalls when above-average rainfall events occurred between November 2010 and February 2011, affecting rail operations and coal availability. In Newlands, the shortfall was not sufficient to trigger take or pay.

As noted earlier, stakeholders raised a concern relating to the assessment of take-or-pay arrangements in the revenue cap process, specifically with regard to the application of the capping mechanism under each access agreement when take-or-pay is triggered. The principle behind the capping mechanism under both UT2 and UT3 is that any surplus above system allowable revenues should be returned to access holders.

This intent is reflected in both UT2 and UT3 standard access agreements, but the provisions detailing the methodology for capping what is returned or recovered from access holders under take-or-pay differs between these types of access agreements. More specifically:

(a) the differential treatment of the cap between UT2 and UT3 standard access agreements means that total actual revenues calculated for UT3 agreements includes variations in rebates due to volume changes, while total actual revenues calculated for UT2 agreements excludes variations in rebates due to volume changes; and

(b) where there is any ambiguity between the application of a standard access agreement and the approved access undertaking, the standard access agreement takes precedence (effectively re-enforcing the differential treatment).

The Authority understands that there is an outstanding matter between QR Network and one of its access holders about how these various calculations are made, the effect of which would be to alter the balance of how much take-or-pay revenue is recovered from that customer and how much revenue is recovered from other customers through the revenue cap mechanism.

The Authority had originally considered this matter in February 2012 but held off making a final decision until it had a better understanding of the issues in question. The Authority understands that this matter is on-going and the Authority has not been provided with additional information to better understand the nature of the alternative views of QR Network and the access holder. However, QR Network has requested the Authority to finalise its revenue cap decision now.

In part, this is because the 2010 undertaking requires the Authority to form a concluded view on the revenue cap adjustment and to include that decision as part of its approval of revised reference tariffs for 2012-13 prior to 4 July 2012.

It is not ideal that the Authority has not received all of the information that it would have liked to receive to finalise its view on this matter. Nevertheless, the Authority notes that, if the access holder's view is upheld, QR Network would have to make an additional payment to the access holder. This payment will however not be able to be recovered (through the revenue cap mechanism or on any other basis) as the Authority will have already concluded its consideration of that matter.

The Authority is, therefore, prepared to finalise its view on the revenue cap adjustment on the basis proposed by QR Network as QR Network alone bears the risk of the access holder's view being upheld and third parties will not be adversely affected.

In doing so, the Authority makes no judgement regarding the relative merits of the parties' positions on this matter.

Capping and Rebates

Stakeholders and QR Network generally agree that the correct mechanism for applying the cap to UT3 take-or-pay arrangements is not completely clear from either the standard access agreements or the 2008 and 2010 undertakings, particularly with regard to how rebate variations should be applied to the take-or-pay arrangements. As a consequence, QR Network has proposed to apply the variations proportionately across UT2 and UT3 arrangements.

QR Network's reasons for allocating the rebate variation in proportion to the value of UT2 and UT3 take-or-pay are based on:

(a) the principle, contained in both the standard access agreements and 2008 and 2010 undertakings, of proportional allocation of take-or-pay across all access agreements other than UT1; and

(b) the significant incremental impact on UT3 take-or-pay amounts relative to UT2.

The effect of QR Network's proposed approach is that the balance of the rebate variation adjustment is effectively transferred back to all access holders through the revenue cap mechanism. To the extent that access charges pass through haulage contracts to end customers, the adjustment is then returned and shared across all customers and not just UT3 customers.

In essence, the 2010 undertaking does not preclude QR Network from including any difference between the forecast and actual rebate payments into the revenue capping mechanism. In seeking to apply this sharing mechanism to the treatment of any under/over payments of rebates, QR Network has exercised a degree of discretion in interpreting the undertaking, as it is not definitive in this matter.

QR Network provided the Authority with independent consultants' advice on the models used to determine take-or-pay calculations under UT2 and UT3 access agreements for each coal system. QR Network was also able to demonstrate that its rebate model was based on the net present value (NPV) of the rebates payable to recover each mining company's initial capital contribution based on the difference between forecast and actual tonnes available. The Authority has tested the information provided by QR Network and is satisfied that QR Network has adhered strictly to the interpretation of each standard access agreement (i.e. UT2 or UT3) for triggering take-or-pay arrangements and have consistently done so for each take-or-pay calculation for each system.

Although Asciano and QRC remain concerned that there are inconsistencies with the treatment of the capping mechanism between the different types of standard access agreements, they nonetheless agree that attempting to retrospectively make alterations to existing agreements and contracts, at least without agreement of the contracted parties, is not an appropriate way to address the issue.

This remains the one area of uncertainty with QR Network's 2010-11 revenue cap application and the Authority will continue to assess QR Network's approach, in particular with the benefit of the outcome of the current dispute on this matter.