

Queensland Competition Authority

File Ref: 1234527

7 April 2017

Mr Alex Kummant
Executive Vice President
Aurizon Network Pty Ltd
GPO Box 456
Brisbane Qld 4001

Dear Mr Kummant

Aurizon Network's 2015–16 revenue adjustment amount application

The Queensland Competition Authority (QCA) has approved Aurizon Network's application for a 2015–16 revenue adjustment amount in relation to the central Queensland coal network.

The total approved adjustment amount in 2015–16 reflects an over-recovery of \$20.6 million, comprising a \$23.3 million over-recovery in non-electric revenues and a \$2.7 million under-recovery in electric revenues.

Aurizon Network submitted its application on 7 October 2016 under the 2010 access undertaking (2010 AU) that was in force then. The QCA has considered this application under the 2016 access undertaking (2016 AU), which came into effect on 11 October 2016. In accordance with the transitional provisions of the 2016 AU, the QCA has applied the process set out in the 2010 AU to assess this application.

The QCA's assessment of Aurizon Network's application is summarised in **Attachment 1**, which will be published on the QCA's website, along with this letter.

This letter of approval constitutes a written notice for the purposes of clause 3.2.12 of Part B, Schedule F of the 2010 AU.

Yours sincerely



Charles Millsteed
Chief Executive Officer

cc: Ms Donna Bowman, Network Regulation Manager, Aurizon Network

ATTACHMENT 1: REVENUE ADJUSTMENT AMOUNTS 2015–16

Background

On 7 October 2016, Aurizon Network submitted its 2015–16 revenue adjustment amount application, proposing to return to access holders a revenue over-recovery of \$20.6 million.

The QCA invited comments from stakeholders and received a submission from Pacific National. Aurizon Network did not make a response submission. Aurizon Network's proposal and Pacific National's submission are available on the QCA's website.

The QCA considered Aurizon Network's proposed 2015–16 revenue adjustment amounts in light of the information Aurizon Network provided and the comments Pacific National made.

Aurizon Network's proposal

Aurizon Network proposed a total revenue adjustment amount in 2015–16 of \$20.6 million (Table 1), comprising:

- \$23.3 million over-recovery in revenues for AT_{2–4} reference tariffs (non-electric revenues)—with returns to access holders of \$26.4 million for the Goonyella system, \$0.2 million for the Moura system, \$2.6 million for the Newlands system, and \$1.8 million for the Goonyella to Abbot Point (GAP) system, offset by a \$7.6 million shortfall in the Blackwater system
- \$2.7 million under-recovery in revenues for AT₅ reference tariffs (electric revenues)—with a return to access holders of \$2 million in the Goonyella system offset by a \$4.8 million shortfall in the Blackwater system.

Table 1 Revenue adjustment amounts 2015–16 (\$m, nominal)

Systems	Non-electric revenues	Electric revenues	Total adjustment amount 2015–16
Blackwater	7.6	4.8	12.4
Goonyella	(26.4)	(2.0)	(28.4)
Moura	(0.2)	–	(0.2)
Newlands	(2.6)	–	(2.6)
GAP	(1.8)	–	(1.8)
Total adjustment amount	(23.3)	2.7	(20.6)

Any discrepancies between totals and sums of components are due to rounding.

Aurizon Network calculated the revenue adjustment amounts by subtracting total actual revenues from its adjusted system allowable revenues for the applicable reference tariffs.¹

¹ Aurizon Network, *FY2016 Revenue Adjustment Amounts, Explanatory Memorandum*, October 2016

Aurizon Network said that its 2015–16 system allowable revenues are from the approved May 2016 extension draft amending access undertaking (May 2016 Extension DAAU). Aurizon Network applied the 2010 access undertaking (2010 AU) provisions to adjust those system allowable revenues to account for the differences between actual and forecast escalation indices on maintenance and operating costs, and the difference between actual and allowed electric energy connection costs.

Aurizon Network's total actual revenues are based on what it is entitled to earn regardless of whether or not it collected this amount. This includes revenues associated with reference train services (including adjustment charges approved by the QCA in September 2016), take-or-pay obligations and other revenues (including revenue adjustments).

Stakeholder comments

Pacific National raised concerns² with Aurizon Network's socialisation of rebate adjustments in the revenue cap process and with the reliability of Aurizon Network's revenue forecasts, noting that there was scope for improvement in Aurizon Network's forecasting methods.

QCA's assessment

Aurizon Network submitted its proposed 2015–16 revenue cap adjustment amounts on 7 October 2016 under the 2010 AU. The 2010 AU was replaced by the 2016 AU, which came into effect on 11 October 2016. Therefore, the QCA considered the proposal under the transitional provisions in the 2016 AU, specifically under clauses 12.4(d) and (e), which state:

If the Approval Date is not the first day of a Year, then this Undertaking will apply in respect of any calculation of Revenue Adjustment Amounts, adjustments to the Second Year Allowable Revenue and other revenue cap calculations in relation to the whole of the Year within which the Approval Date falls (clause 12.4(d)).

If the Approval Date occurs prior to the calculation of Revenue Adjustment Amounts, adjustments to Second Year Allowable Revenue and other revenue cap calculations for the preceding Year being undertaken and submitted to the QCA for approval, then those calculations may still be undertaken, and submitted to the QCA, by Aurizon Network as though the provisions under the 2010 Undertaking still applied in respect of those calculations and their approval by the QCA (clause 12.4(e)).

Taken together these transitional clauses provide for the QCA to apply the 2016 AU process to assess the 2016–17 revenue adjustment amounts (as per cl. 12.4(d)) and apply the 2010 AU process to assess the 2015–16 revenue adjustment amounts (as per cl. 12.4(e)), which is the matter being assessed in this decision. The QCA considers this approach to assessing revenue adjustment amounts is consistent with the policy intent to assess revenue cap amounts for a year (here 2015–16) under the regime which was in place prior to the end of that particular year. The QCA considers that this approach will promote regulatory certainty.

Therefore, the QCA has applied the 2010 AU process to assess the 2015–16 revenue adjustment amounts. The 2010 AU approval criteria and our assessment are set out below.

Approval criteria

The QCA will approve the revenue adjustment amounts if it is reasonably satisfied they are calculated in accordance with provisions set out in clause 3.2 of Part B, Schedule F of the 2010 AU. These provisions provide

² Pacific National, *Response to the Aurizon Network Submission 2015–16 Revenue Adjustment Amounts to QCA*, December 2016

for Aurizon Network to annually submit the revenue adjustment amounts for the AT_{2–4} and AT₅ reference tariff for each system in the central Queensland coal network. The revenue adjustment amounts are the difference between revenues earned (total actual revenues) and revenues allowed (adjusted system allowable revenues) for the relevant reference tariff components, and calculated as per clause 3.2 of Part B, Schedule F (Table 2).

Table 2 Components of adjusted system allowable revenues and total actual revenues for 2015–16

<i>Adjusted system allowable revenues</i>	<i>Total actual revenues</i>
<ul style="list-style-type: none"> • Approved 2015–16 system allowable revenues (May 2016 Extension DAAU) • Actual maintenance cost escalation—adjustment to reflect the difference between actual and forecast maintenance costs index (MCI) • Actual operating cost escalation—adjustment to reflect the difference between actual and forecast consumer price index (CPI) • Costs of electric energy for traction, and cost of connecting Aurizon Network's electric traction system to electric transmission or distribution network—adjustment to reflect the difference between actual and forecast costs • Maintenance costs of branchlines for new loading facilities (where applicable) 	<ul style="list-style-type: none"> • Total revenues from AT_{2–4} and AT₅ reference tariffs, including cross-system train services revenues (including adjustment charges) • Annual take-or-pay entitlements • Relinquishment fee entitlements • Rebate adjustment—rebateable revenues within approved system allowable revenue less any rebates paid

Adjusted system allowable revenues

The QCA found Aurizon Network's 2015–16 system allowable revenues to be consistent with transitional revenues contained in the May 2016 Extension DAAU approved by the QCA in June 2016. Also, the QCA noted that the approved 2015–16 system allowable revenues in the 2016 AU are the same as the transitional revenues.

Aurizon Network's adjustments to the approved 2015–16 system allowable revenues accounted for:

- *actual maintenance cost escalation*—using the actual, compared to forecast MCI³ to escalate the QCA's approved maintenance cost allowance

The QCA found Aurizon Network correctly calculated the actual MCI for 2015–16, with an annual percentage change of 1.1 per cent, compared to the forecast of 2.4 per cent used in the approved maintenance cost allowance. Actual MCI is a weighted index of consumables, fuel, labour, and accommodation sub-indices derived using publicly available indices.⁴ The QCA is satisfied that Aurizon Network has accurately calculated a decrease in the system allowable revenues of \$2.3 million for non-electric revenues (AT_{2–4}), and \$0.1 million for electric revenues (AT₅).

- *actual operating cost escalation*—using the actual, compared to forecast, CPI to escalate the QCA's approved operating cost allowance

³ Note: Aurizon Network used forecast MCI on Table 76 of the QCA's 2014 DAU final decision (Vol 4 – MAR).

⁴ Publicly available indices are published by the Australian Bureau of Statistics and Australian Institute of Petroleum, as outlined in Table 77 of the QCA's 2014 DAU final decision (QCA, Aurizon Network 2014 DAU, final decision, vol. 4—Maximum Allowable Revenue, April 2016). Weights are as outlined in Table 79 of the QCA's 2014 DAU final decision.

The QCA found Aurizon Network used the actual CPI for 2015–16 of 1.5 per cent (confirmed from ABS All Groups CPI Brisbane data), compared to the annual forecast CPI of 2.5 per cent used in the approved operating cost allowance. The QCA is satisfied that Aurizon Network has accurately calculated the net decrease of \$1.2 million for non-electric revenues (AT_{2–4}).

- *components relating to the recovery of Aurizon Network costs of connecting its electric traction system to a transmission or distribution network*—adjustments to reflect the difference between the actual connection costs paid to Powerlink and the connection cost allowance included in the calculation of the AT₅ reference tariff component for 2015–16

The QCA is satisfied Aurizon Network has accurately calculated the net increase of \$1.5 million to the system allowable revenue reflected in the AT₅ reference tariff component, related to connection costs for 2015–16.

The QCA noted that Aurizon Network did not make any adjustments in relation to maintenance costs for new branchlines.

The QCA noted that Aurizon Network did not make adjustments to reflect the difference between actual and forecast electric traction costs (EC) paid to Origin Energy Limited for the consumption of electric energy, which resulted in an over-recovery of \$6.3 million in 2015–16. At the time of its 2015–16 revenue cap submission, Aurizon Network said this over-recovery was included in its proposed 2016–17 EC tariffs, as part of its amended 2014 DAU. The QCA is satisfied that the \$6.3 million over-recovery is reflected in the approved 2016–17 EC tariffs in the 2016 AU, and Aurizon Network's proposal to not include this amount in the 2015–16 revenue adjustment amounts avoids double counting.

Overall, these adjustments represent a total net reduction of \$2 million to the approved 2015–16 system allowable revenues, from \$957 million to \$955 million (see Table 3).

Total actual revenues

Aurizon Network submitted that its total actual revenues for 2015–16 are based on revenues associated with reference train services (including cross-system train services), take-or-pay amounts, rebate adjustments and relinquishment and transfer fees received.

- *Revenues from reference train services including cross-system train services*—the QCA has confirmed that reference tariff revenues were accurately estimated based on:
 - the approved reference tariffs (in the May 2016 Extension DAAU)
 - actual railings (i.e. tonnages and origin/destination).

In doing so, the QCA is satisfied that Aurizon Network's actual revenues have been calculated in accordance with the relevant provisions in the 2010 AU, including:

- using accurate actual railing information—Aurizon Network's railing information has been verified against billing and published informations
- accurately estimating revenues from cross-system train services—revenues were estimated based on the use of appropriate reference tariffs, calculated in accordance with the cross-system traffic requirements in the 2010 AU.

⁵ From Aurizon Network's Quarterly Performance Reports and 2015–16 Annual Report

As noted above, Pacific National raised concerns on the accuracy of forecasting revenue and the need for improvements in forecasting. The QCA considers that while some degree of uncertainty will remain in forecasting revenues (including volumes), these issues would be considered further as part of the approval process for the next access undertaking.

- *Take-or-pay amounts and rebate adjustments*—take-or-pay arrangements related to non-electric systems were triggered in 2015–16 in Blackwater and Goonyella, with total take-or-pay revenues of \$3 million collected by Aurizon Network. The QCA is satisfied that the take-or-pay revenues as well as rebates repaid to some customers were accurately estimated, on the basis that:
 - railings within a nominated month, for the purposes of annual and variable take-or-pay, were consistently treated, including being consistent with previous years' treatment, and that any cancellations (if any) due to a 'QR Cause' were appropriately attributed
 - the methodology in standard access agreements for various access undertakings (i.e. UT1, UT2 and UT3) has been applied correctly
 - rebates for particular mines, which are payable irrespective of whether take-or-pay is triggered, have been determined separately and correctly.

Pacific National remained concerned about rebate treatment in Aurizon Network's revenue adjustments. It viewed these as commercial arrangements, which are separate from the allowable revenues and regulatory process. Pacific National did not agree with the 'socialisation' of these rebate adjustments and believed that more equitable rebate adjustment methods should be considered in future commercial agreements and future access undertakings.

While the QCA notes Pacific National's concern, the QCA is satisfied the rebate calculations in the 2015–16 revenue adjustment amounts are consistent with Part B of Schedule F, 2010 AU.

- *Relinquishment and transfer fees*—under the relevant access agreements (i.e. UT1, UT2 and UT3), access holders must pay Aurizon Network a relinquishment or transfer fee to relinquish or transfer access rights or initiate capacity transfers. These relinquishment and transfer fees, according to the 2010 AU, must be reflected as an equivalent amount payable in Aurizon Network's total actual revenues received.

The QCA considers that Aurizon Network has correctly included transfer and relinquishment fees to total actual revenue in accordance with clause 3.2.3(b), Part B of Schedule F of the 2010 AU.

Overall, the QCA is satisfied that Aurizon Network's total actual revenues of \$975.5 million reflect total actual revenues collected (or deemed to have been collected) for 2015–16.

Final decision

For the reasons outlined above and having regard to the relevant obligations contained in the 2010 AU, the QCA has approved Aurizon Network's proposed \$20.6 million net return to access holders for 2015–16. Table 3 below shows a breakdown of this amount, by coal system and by non-electric and electric assets.

Table 3 System allowable revenues against total actual revenues (\$m, nominal)

<i>System</i>	<i>System allowable revenue, Schedule F</i>	<i>Adjustments (MCI + CPI, connection charges adjustments)</i>	<i>System allowable revenue</i>	<i>Reference tariff revenue (excluding cross-system revenue)</i>	<i>Take-or-pay, transfer fees, cross-system revenue</i>	<i>Rebate adjustment</i>	<i>Total actual revenue</i>	<i>Revenue cap adjustment amount</i>
Non-electric (AT₂₋₄)								
Blackwater	322.4	(1.4)	321.0	308.4 290.6 37.0 31.0 118.0 785.1	6.1	(1.1)	313.3	7.6
Goonyella	277.7	(1.4)	276.3		11.8	0.3	302.7	(26.4)
Moura	40.1	(0.2)	40.0		3.1	–	40.1	(0.2)
Newlands	28.1	(0.1)	28.0		–	(0.4)	30.6	(2.6)
GAP	116.6	(0.3)	116.3		–	–	118.0	(1.8)
Subtotal	784.9	(3.4)	781.5		20.9	(1.3)	804.8	(23.3)
Electric (AT₅)								
Blackwater	99.5	(0.2)	99.3	88.1 74.9 163.0 948.1	6.4	–	94.5	4.8
Goonyella	72.7	1.6	74.3		1.2	0.2	76.3	(2.0)
Subtotal	172.1	1.4	173.5		7.6	0.2	170.8	2.7
Total	957.0	(2.0)	955.0		28.5	(1.1)	975.5	(20.6)

Note: Any discrepancies between totals and sums of components are due to rounding.