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21 April 2011

Mr Michael Carter  
Executive Vice President and Chief Executive Officer  
QR National Network Services Pty Ltd  
GPO Box 456  
Brisbane QLD 4001

Dear Mr Carter

**Approval of QR Network's Revenue Cap Adjustment Amounts 2009-10**

The Authority has approved QR Network's proposed 2009-10 revenue cap adjustment amounts. The combined total of the revenue adjustment amounts represents a net return to access holders of around \$0.15 million comprising an over-recovery of \$6.1 million in non-electric revenues, and an under-recovery of \$5.9 million in relation to electric revenues.

These adjustment amounts will result in a net downwards and upwards variation in the non-electric and electric reference tariffs (respectively) in 2011-12.

In line with the arrangements in the 2010 access undertaking, the reference tariff adjustments will be finalised as part of the tariff review process that also takes account of updated volume forecasts. In this regard, it is noted that the Authority has commenced its public consultation process on QR Network's annual review of reference tariffs application that was received on 11 April 2011.

The Authority's assessment of QR Network's application is summarised in **Attachment 1**.

This letter of approval constitutes a written notice for the purposes of clause 3.2.12 Part B of Schedule F of the access undertaking.

Yours sincerely



EJ Hall  
Chief Executive

## QR Network Revenue Cap Adjustment 2009-10

### Summary of QR Network's Application and the Authority's Assessment

#### Background

QR Network's 2010 access undertaking provides for QR Network to seek the Authority's approval of coal system revenue cap adjustment amounts for each coal system each year in relation to:

- (a) non-electric revenues (AT<sub>2-4</sub> revenue adjustment amounts); and
- (b) electric revenues (AT<sub>5</sub> revenue adjustment amounts).

If QR Network over-recovers its approved revenues, it can also seek to retain some of this revenue provided it can demonstrate that it has achieved productivity improvements that have benefited the whole of the coal supply chain.

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. There are also differences in the way the revenue adjustment amount is assessed.

QR Network submitted its revenue cap adjustment application on 30 November 2010. The Authority published QR Network's proposal and received submissions from Asciano and the Queensland Resources Council (QRC) and then another submission from QR Network in response to matters raised in the stakeholders' submissions.

#### QR Network's Proposal

QR Network estimated a revenue over-recovery in 2009-10 of \$0.15 million. This was comprised of \$6.10 million over-recovery in relation to non-electric assets (AT<sub>2-4</sub> revenue tariff components) and a \$5.95 million shortfall in relation to electric assets (AT<sub>5</sub> reference tariff component) – see **Table 1** for details.

**Table 1 – Revenue adjustment amounts 2009-10 (\$m)**

<i>System</i>	<i>Non-Electric Revenues</i>	<i>Electric Revenues</i>	<i>Total Adjustment Amount 09-10</i>
Blackwater	(4.48)	(8.08)	(12.56)
Goonyella	4.30	2.13	6.43
Moura	1.82	-	1.82
Newlands	4.45	-	4.45
<b>Total Adjustment Amount</b>	<b>6.10</b>	<b>(5.95)</b>	<b>0.15</b>

QR Network calculated this revenue over-recovery by subtracting its 'actual' revenues (\$616.41 million) from its 'adjusted 2009-10 revenues' (\$616.26 million) – where the:

- (a) 'adjusted 2009-10 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, regardless of whether or not it collected this amount, 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).

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**

	<i>Approved Revenue Caps</i>	<i>MCI + CPI Adjustment</i>	<i>Energy and Connection Charges Adjustment</i>	<i>Total Adjusted System Allowable Revenues</i>	<i>Reference tariff revenues (Actual)</i>	<i>Non-reference tariff revenue (Actual)</i>	<i>Transfer Fees and Rebate Adjustments</i>	<i>Total Actual Revenues</i>
<b>Non-electric Revenues (AT<sub>2-4</sub>) (\$m)</b>								
Blackwater	203.85	0.67	-	<b>204.53</b>	187.91	9.91	2.21	<b>200.04</b>
Goonyella	215.33	0.80	-	<b>216.13</b>	207.89	11.89	0.65	<b>220.43</b>
Moura	29.31	0.14	-	<b>29.46</b>	31.28	-	-	<b>31.28</b>
Newlands	32.77	0.12	-	<b>32.89</b>	36.47	0.95	(0.08)	<b>37.34</b>
Sub-total	481.27	1.73	-	<b>483.00</b>	463.56	22.75	2.79	<b>489.10</b>
<b>Electric Revenues (AT<sub>5</sub>) (\$M)</b>								
Blackwater	63.23	0.05	0.33	<b>63.61</b>	51.14	4.39	-	<b>55.53</b>
Goonyella	71.01	0.06	(1.41)	<b>69.65</b>	70.53	1.26	(0.01)	<b>71.78</b>
Sub-total	134.24	0.11	(1.08)	<b>133.26</b>	121.67	5.65	(0.01)	<b>127.31</b>
<b>Totals</b>	<b>615.50</b>	<b>1.83</b>	<b>(1.08)</b>	<b>616.26</b>	<b>585.23</b>	<b>28.40</b>	<b>2.78</b>	<b>616.41</b>

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

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. In particular, QR Network indicated that, while it has received a claim for an incident on the Blackwater system in February 2010, the train services affected by this incident are below the relevant thresholds for a deduction from the revenue cap adjustment.

### Stakeholders' Comments

Asciano and QRC's submissions focussed on the lack of information publicly available and, in particular, the need for QR Network to better quantify and explain the key drivers of the revenue cap variations between the different coal systems and revenue components (i.e. electric and non-electric revenues).

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

### Assessment Criteria

The 2010 undertaking states that the Authority will 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 over-recovery. Also, and as provided for in the undertaking, the review focused on the revenues that QR Network was entitled to earn whether or not it actually collected this amount, less any required deductions.

### **Assessment of QR Network’s Proposal**

Even though QR Network over-recovered its 2009-10 revenue cap, it did not seek an increment to its revenues for any whole of coal supply chain productivity improvements.

#### *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 of 6.7% (compared to the forecast of 5.6% used in the approved revenue caps) less the approved x-factor, resulting in a net increase of \$1.54 million;
- (b) an actual CPI value for the year of 4.5% – compared to the forecast of 3.9% used in the approved revenue caps less the approved x-factor, resulting in a net increase of \$0.29 million; and
- (c) an actual cost of \$58.62 million for electric energy and traction costs – compared with \$59.70 million, resulting in a net decrease of \$1.08 million.

QR Network’s MCI and CPI were assessed using ABS’s published data for the relevant indices and against 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. The Authority also verified that QR Network had appropriately applied the methodologies in the access undertaking, the relevant standard access agreement or its internal 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 significant 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 CQCR and non-CQCR systems where necessary;
- (c) *take-or-pay revenues* – were accurately estimated on:
  - (i) actual railings and contractual commitments in access agreements; and
  - (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;
- (d) *relinquishment and transfer fees* – were confirmed based on:
  - (i) consistency with the modelled train paths and the contracted train paths in QR Network's internal access agreements with access holders; and
  - (ii) access holders advice confirming the information 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 over-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 difference between the railings QR Network used to calculate its revenues and that provided by the coal companies was negligible (i.e. 90% of the tonnages railed were verified with less than a 1% difference); 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, Relinquishment Fees and Transfer Fees

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).

QR Network confirms that it was not entitled to earn any take-or-pay amounts for the 2009-10 year as the relevant 'trigger test' for take-or-pay for each system was not met. In addition, no access rights were amended which entitled QR Network to earn revenue from Relinquishment Fees.

During 2009-10, one transfer occurred in the Goonyella system which entitled QR Network to earn revenue from a transfer fee of around \$0.3 million (return to access holders). The relevant access holder confirmed that this fee had been paid.

### *Issues of Note*

#### QR cause

The take-or-pay arrangements provide for QR Network to recover revenue from access holders where contracted service levels are not met. This arrangement is limited to the extent that 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. QR cause.

The revenue cap mechanism allows QR Network to recover the shortfall in take-or-pay revenues due to QR cause, except where the cancellations resulted in the non-provision of 10% or more of the total number of train services for any origin-destination pair over the relevant year and are the result of QR Network's breach of an access agreement or negligence.

A review of QR Network's financial model indicates that, while there were a number of cancellations due to QR cause in February 2010 and March 2010 (e.g. 29% and 14% of total train services respectively), these cancellations were due to extreme weather events from December 2009 that affected the Blackwater system. Neither QR Network nor its users have indicated that these cancellations were due to breach or negligence on the part of QR Network.

However, it is evident that, in examining this matter, QR Network's information systems find it difficult to discriminate between the events that have resulted in a cancellation e.g. maintenance and bad weather. This is particularly problematic from the Authority's perspective as QR Network has regulatory responsibilities in this area that date back to 2007, and contractual responsibilities that pre-date this. The Authority will be seeking QR Network's cooperation to ensure that it develops appropriate information systems that will enable it to verify its compliance with its regulatory and contractual responsibilities.