Chapter 5 - Pricing Principles

KEY ASPECTS

Price objectives - the Undertaking should allow QR to generate sufficient revenue to maintain its incentive to invest in its infrastructure. If there is a conflict between QR pursuing revenue adequacy and non-discriminatory pricing in a particular market, then the latter will prevail unless QR can justify the price difference to the QCA.

Price differentiation - should be subject to a test in which all railway operators for a traffic in a geographic area would be subject to price differentiation on only cost or risk grounds, or a change in market circumstances (whether or not they are competing head-to-head). QR should bear the onus of justifying price differences.

Efficient costs - the pricing limits, based on stand alone and incremental costs, should only reflect those costs efficiently incurred.

Rate review - access agreements should contain rate review provisions, including for instances when third-party operators can demonstrate that QR has sold a ‘like’ train path to another operator for a lower price than its own.

Costing Manual - should provide confidence in the integrity of the separation of costs between above and below-rail activities and be a reliable source for the evaluation of access charges. A strong audit procedure is required to improve confidence in the cost allocation process.

Reporting - for the Undertaking to be effective, it is necessary there be a regime of transparent financial and performance reporting in relation to the provision of below-rail services.

5.1 Introduction

In any market, prices play a central role in co-ordinating commercial activity. The market involving the provision of rail infrastructure by QR is no different. The pricing principles discussed in this chapter will underpin the development of access charges which in turn will substantially influence the evolution of the above-rail market.

The pricing principles adopted are critical to protecting QR's legitimate business interests. For example, if the pricing principles prevented QR from generating sufficient revenue, QR might not have sufficient incentive to undertake new investment in, and maintenance of, its rail infrastructure. Under-investment in or insufficient maintenance of rail infrastructure could ultimately impose costs on the economy as great as those from an environment where an excessive profit is allowed to be earned by a monopoly provider. It is also important that the pricing principles provide QR with an incentive to innovate to better meet customer needs in the services it provides.

The pricing principles are also important to protecting the legitimate business interests of above-rail operators and end customers. QR's pricing principles should not enable an excessive return to be realised by QR's below-rail business. It is also critical that access charges not distort competition in the above-rail market, by discriminating, on other than cost grounds, between QR's above-rail groups and third-party operators or between different third-party operators.

The pricing principles will also influence the evolution of the above-rail market and the efficient utilisation and expansion of the network. In a competitive market, above-rail operators will develop rail transport solutions that take into account the access charges they will be levied. Access charges must therefore be consistent with efficient utilisation and expansion of the rail infrastructure.

5.2 Pricing Objectives

5.2.1 Appropriateness of revenue adequacy objective

Background

The QCA accepted revenue adequacy as a legitimate pricing objective for QR to adopt, so long as it was to be pursued in a manner that minimises distortions to commercial activity in the above-rail market. Consequently, the QCA proposed revenue adequacy should be subject to the overriding requirement that in the event there is a conflict between QR pursuing revenue adequacy and non-discriminatory pricing in a particular market, then the latter objective would prevail, unless QR could justify the price difference to the QCA.

The QCA also proposed revenue adequacy be pursued in the context of efficient operations and the efficient level of assets actually required to provide the below rail service.

Stakeholder views

Appropriateness of revenue adequacy objectives

QR - believes that efficient costs, where discussed in terms of revenue adequacy, represent the target costs that QR should apply to pricing at the end of the regulatory period. Alternatively, reasonable costs are the costs to be applied at various points during the transition to efficient costs. Both the QCA and QR have recognised the importance of a transition period for QR to achieve the efficient cost target. Indeed, a transition period (and in fact the revenue adequacy principle itself) is required to ensure QR's ability to maintain its infrastructure in the long term. QR has no objection to the undertaking clarifying the meaning of reasonable costs as described above.

Concern is also raised by the QCA that potential exists for QR's revenue adequacy principle to conflict with the undertaking's requirement that QR price consistently. In such an event, the QCA believes there is scope for QR to favour its revenue adequacy objective over its non-discriminatory pricing principle. QR does not agree with this QCA view, considering that the terms of the undertaking already preclude this event. However, QR is willing to further clarify this position in the undertaking.

RTBU - the QCA's Draft Decision reflects a deliberate effort to impose on QR a requirement that it introduce artificially low access charges. The effect of the Draft Decision will be to erode the viability of QR's coal freight business – and require Queensland taxpayers to provide disguised subsidies to mining companies operating in Queensland.

The overall impact of the Draft Decision is that QR's access charges would be far lower than the charges any stand-alone private sector business could afford to charge, and still make an acceptable financial return.

A more transparent approach to setting regulated prices would be to openly incorporate allowances for capital investment required to upgrade an enterprise's productive capacity or to undertake capital works which will repair, restore or upgrade infrastructure.

Such an approach would establish 'ceiling' prices in a two-stage process:

- by estimating the base prices that would produce an acceptable pre-tax rate of return within a comparatively short time frame (3 – 5 years) on its start of period investment in relevant infrastructure and associated assets; and

- by calculating an additional allowance to be incorporated in access prices for the capital expenditure required to upgrade existing infrastructure to an acceptable standard of functionality - within a similar (or longer) time span.

This approach would address the issues of a return on existing investment and an appropriate allowance for the maintenance, renewal and upgrading of infrastructure, which it considers the Draft Decision does not. The QCA's Draft Decision reflects a misunderstanding of accounting issues when it announces that QR's 'allowable' costs for the purposes of calculating maximum rates of return should include a 15% reduction in maintenance expenditure (Amendment 47). This determination overlooks or ignores the statement by RSA that QR's 'maintenance plan' and its Network Development Plan both "include activities that may for accounting purposes be classified as capital expenditure or recurrent expenditure".

The QCA's Draft Decision 'accepts that revenue adequacy is a legitimate pricing objective', but then largely ignores one of the key elements of QR's submissions on revenue adequacy: i.e. that access charges should incorporate an element for capital expenditure on upgrading, replacing or even extending components of infrastructure to support the provision of access to Third Party operators.

The fact is that any pricing regime which allows a commercial return on investment in below-rail activities, and also allows a premium to be charged to meet the costs of infrastructure renewal, upgrading or extension would appear in simple accounting terms to be generating an 'excessive return from below-rail commercial activities'. The QCA would therefore view this as a 'distortion'.

Plainly the QCA should adopt a two-part pricing regime, which clearly separates the two components of pricing, in the manner outlined earlier in this submission.

The QCA's observations may be restated as indicating that prima facie, the QCA has *rejected QR's* proposals for access prices to be adjusted to allow them to incorporate some degree of contributions for the maintenance, renewal and extension of infrastructure. This should be of profound concern to the Queensland Government, and the Queensland community. Unless the QCA's approach is amended in the final decision, it condemns QR to inappropriate caps on access charges, and will therefore starve QR of the funds required to appropriately manage and maintain the infrastructure to be used by private sector operators.

RTBU raised an issue about the QCA's recommendation regarding the 'efficient level of assets actually required to provide the service' (Amendment 18) and the fact that it contemplate the use of the replacement values of ‘modern engineering equivalent’ assets. The RTBU’s discussion of the use of MEERA is discussed in more detail in 13.1.

ARTC - there are some similarities between ARTC’s pricing principles and those proposed by the QCA. These include revenue adequacy, equitability, efficient practice, asset valuation and rate of return.

PCQ - QCA accepts QR’s objective to achieve revenue adequacy and further states that it will tighten the definition of revenue adequacy and emphasises the importance of non-discriminatory pricing.

In considering these issues it is important to ensure an adequate return on capital so that the below rail owner is capable of investing in greater capacity. In particular, it is often necessary to invest in infrastructure that provides significantly more capacity than that which is required. For example, the minimum possible below rail system upgrade could provide additional capacity of 5 mtpa when only 2 mtpa is required. If the below rail system owner will only get a return on 40% of the investment then it is unlikely that the investment will be made. It is therefore important that any revenue adequacy definition properly accommodates the ‘lumpiness’ in providing additional infrastructure capacity so that development of significant projects are not constrained.

This issue is also particularly important in the current climate where many of the mines on the Goonyella system are seeking additional rail and port capacity. Failure to provide adequate returns will prejudice the ability of the below rail owner to provide the expected significant on-going investment in the rail system to meet this demand.

QMC - approves of the QCA’s treatment of the various components of Network Access’ allowable access revenue (efficient costs, rate of return, depreciated/optimised asset values) with the important exception of contributed assets.

QCA’s analysis

There appears to be stakeholder support for the QCA’s findings with respect to QR’s pricing objectives. QR has noted that it considers ‘efficient’ costs are the target costs that QR should apply to pricing at the end of the regulatory period, and that a transition period is required in order for QR to achieve this target. ‘Reasonable’ costs are the costs that apply at various points during the transition to efficient costs. The QCA supports a transition period for QR to achieve its efficient cost target as part of this first review, but does not consider it appropriate to entrench pricing based on inefficient costs as QR is suggesting. Consequently, prices should be based on efficient costs rather than ‘reasonable’ costs irrespective of whether transitional arrangements are included as part of the regime. The QCA is of the view that the two issues should be kept separate.

PCQ argues that, in considering QR’s pricing objectives, it is important to ensure an adequate return on capital so that the below-rail owner is capable of investing in greater capacity. It should be noted that the QCA made substantial accommodation in the optimisation process for the lumpiness of the investment. In particular, all of QR’s infrastructure (apart from duplicated track between Rocklands and Callemondah) was incorporated into the valuation even though the QCA’s advice was that not all of it was in fact required to perform the traffic task.

RTBU has argued that the pricing regime proposed by the QCA does not allow QR to earn an adequate return on its existing investment nor allow for the maintenance, renewal and upgrading of infrastructure. RTBU appears to have misunderstood the QCA’s approach on this matter.

In determining reference tariffs to apply for coal services, the QCA allowed QR to earn a rate of return equivalent to its post-tax weighted-average cost of capital (WACC) that takes into account the non-diversifiable risks inherent in QR’s below-rail coal assets. This rate of return has been applied to the DORC value of QR’s coal infrastructure, thus ensuring that QR earns a ‘commercial’ return on its existing investment. However, by setting a ceiling price, it prevents QR from earning excessive returns.

RTBU have also argued that the QCA's pricing model does not allow QR to earn sufficient revenue to allow for the maintenance, renewal and upgrading of infrastructure. This is incorrect as the QCA has explicitly included maintenance costs and planned capital expenditure in its assessment of QR's costs for the purposes of setting reference tariffs. This includes an element for capital expenditure on infrastructure augmentation required to handle expected tonnage growth during the regulatory period. QR's forecast costs, including maintenance costs, have been adjusted to reflect the 'efficient' costs that would apply in a competitive environment.

RTBU further makes the point that maintenance costs include activities which may, for accounting purposes, be classified as either capital or recurrent expenditure. This is not a problem in terms of the QCA's assessment of reference tariffs as the approach employed by the QCA, and endorsed by QR, includes recurrent and capital expenditure as cash flows in the periods in which they occur and draws no distinction between them.

The QCA has not changed its position on QR's pricing objectives.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that:

1. **revenue adequacy is considered in the context of efficient operations and the efficient level of assets actually required to provide the service; and**

2. **in the event there is a conflict between QR pursuing revenue adequacy and non-discriminatory pricing in a particular market, then the latter will prevail unless QR can justify the price difference to the QCA.**

5.2.2 Limits on price differentiation

Background

The Draft Undertaking stated two limitations on QR's ability to set differential prices:

- consistent charges for directly competing services (same specified commodity between a specified origin and destination at a similar time); and

- a consistent approach to charges for the same commodity type in the same geographic system.

The QCA proposed QR's ability to price differentiate should be constrained by a market test, such that prices in the same market (limited by commodity, geography etc) should differ only because of identifiable costs or risks, with QR bearing the onus of justifying any price differences. The application of the test would extend to agreements negotiated at different times.

The QCA expressed support for an approach that limited QR's ability to price discriminate within a market, with the onus on QR to justify the inclusion of additional markets. This approach would not prevent service-related price differences within a market.

The Draft Undertaking did not provide a right for a third-party operator to require a rate review in the event that QR sold a like train path at a discount to the operator as part of its access agreement. The QCA considered access seekers should be entitled to such a right for access agreements in markets where reference tariffs do not apply. Under such a mechanism, the third-party operator would bear the onus of establishing a different access charge applied to a like train path and, once established, QR would bear the onus of justifying the difference.

Stakeholder views

> **QR** - there are two major aspects of this recommendation that cause QR major concern. First is the imposition of a constraint on price differentiation within a market such that the only basis for price differentiation is cost and risk, regardless of whether the traffics are directly competing or whether the arrangements have been negotiated at a significantly different time. Second is the use of a limited number of broadly defined markets, which serves to substantially compound the first concern.
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> *Input constraints on price differentiation* - QR's approach in the Draft Undertaking was developed in order to reflect the extent to which price differentiation by QR could be expected to have an impact on competition in a market (where the term market is defined as per the Trade Practices Act). Where two operators are competing head to head, any form of price differentiation by QR that is not based on cost or risk would be expected to have the effect of distorting competition between those operators. However, where two operators are transporting the same product, but in a different geographic area, there is less likelihood that a small difference in price (based on reasons other than cost or risk) would distort competition, either between the two operators or for the users in the end market.
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> The QCA's proposed limits on price differentiation, which restrict price differentiation while taking no account of the potential for it to distort competition in a market, provide a clear constraint upon QR's ability to price efficiently.
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> Further, while appearing to place a clear obligation upon QR, when analysed in greater detail, the intent of the QCA's requirement is unclear. For example, what is the difference in cost or risk between providing access to two different origin/destination combinations? If the initial price for one service is set somewhere between the floor and ceiling price, and QR were then to price access for a longer haul (assuming a percentage of common corridor), is the increase in cost the stand-alone costs of the additional haul length, the incremental cost for the additional haul length, or somewhere in between?
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> Apart from the intent of the QCA's provisions being inappropriately restrictive, QR considers that the detail of the QCA's recommendation lacks any real clarity on how QR prices for traffics within the same 'market'.
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> *Market Definition* - QR believes that the problems associated with the QCA's proposed constraints on price differentiation are infinitely compounded by the QCA's recommendations to specify a limited number of defined markets. The defined markets are very broad, and have been specified without reference to the normal market definition tests, as set out in the Trade Practices Act. An example of this is highlighted by the broad category of *'other bulk product*s'. 'Other bulk products' potentially include the transport of sulphuric acid, woodchips, petroleum, bulk garbage for landfill and sugar.
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> It is highly conceivable that, within the ceiling and floor limits regulating the access charge, operators hauling different traffics within this category would have a different ability to contribute to the fixed costs of QR's network. In this regard, a considerable difference could exist between the haulage of bulk landfill garbage and the haulage of sugar. However, were the first access charge negotiated in this 'market' to be for a high value product, with this high value reflected as an access charge towards the upper end of the allowable range, on the basis that prices should only differ between operators on the grounds of cost and risk, other operators from the same 'market' who later seek to negotiate access would be required to also pay the higher charge.
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> If they were not able to afford this charge, they would not be able to enter the network. Alternatively, if a low price were negotiated in the first instance, then QR would be faced with having to levy a low access charge on an operator that can clearly afford to contribute more to the network, hence limiting QR's ability to achieve revenue adequacy. As this

example shows, the loss of flexibility in pricing could lead to lost revenue by QR, and loss in market share. These costs will be borne not just by QR, but by all industries that have rail as a potential mode of transport.

Changes over Time - the QCA's recommendation for price differentiation only on the basis of cost or risk applies over time as well as at a specific time. The implication of this is that the first price negotiated will have lasting implications for both access seekers and QR alike. It would effectively replace the ceiling limit as the maximum price that QR could charge and would be imposed upon the system indefinitely.

QR believes that the resulting inability for QR to vary prices over time ignores the fact that there may be legitimate reasons for QR wishing to change prices over time. For example, for many of the services operating on QR's network, the access charge that can be levied is effectively capped by the cost of road haulage. If circumstances change to alter the competitiveness of road in comparison to rail, QR will need to be able to respond to this in the context of its access charges.

QR considers that any recommendation by the QCA that constrains QR's ability to vary prices over time to take account of changing market circumstances is contrary to QR's legitimate business interests and is inconsistent with an economically efficient pricing regime.

Public Interest - the QCA approach will impose unnecessary and avoidable costs upon QR, with potential costs extending to third party operators and end-users. The QCA acknowledges the potential costs to QR arising from its defined market recommendation where it states in the Draft Decision that a defined market approach (which would be combined with strict cost-based restrictions on price differentiation within a market) will "potentially limit QR's ability to price differentiate". QR acknowledges that, in the presence of a compelling public interest benefit, the QCA may legitimately impose requirements such as these. However, it must be noted that the key implication of these provisions is for services where no reference tariffs exist.

The focus of the QCA's assessment of public interest has been on the implications of reduced haulage charges for coal. In the context of the public interest associated with the imposition of these constraints for non-coal services, QR believes that, far from demonstrating a compelling public benefit, no definitive statistics or data have been provided in the Draft Decision demonstrating a benefit arising from the QCA's recommended approach. QR considers the existence of such evidence to be essential in considering the imposition of potential costs.

The QCA has stated that the primary aim of recommending inclusion in the QR undertaking of defined markets is to ensure that disputation does not occur with respect to the definition of a market. QR does not consider there is any evidence that significant disputation over the definition of a market is likely to arise with regard to rail services. There are two key reasons for this belief.

First, with the exception of services for which reference tariffs are currently being considered, or are otherwise proposed to be developed (i.e. minerals traffic on the Mt Isa Line), over the six years since the introduction of third party access rights, there has been only been four access enquiries from third parties in relation to the operation of freight services that would fall within the scope of this undertaking. Of these four enquiries, only one could be considered to represent a serious interest in access. There has clearly not a been a significant demand for freight services where reference tariffs are not proposed, and there has been no change in circumstances that would lead to an expectation that a significant demand for these services is likely to materialise in the near future.

Further, the NSW Rail Infrastructure Corporation (RIC) has confirmed that it has yet to have a dispute with regard to market definition in NSW. To date, QR has not yet experienced a market definition dispute in relation to the provision of access. Looking beyond access, in many years of market-based pricing for rail haulage services, QR has not experienced a dispute that would have been resolved by the QCA's proposed market definition.

While the benefits of the QCA's recommended approach are clearly questionable, given the limited demand for these services, the costs that would be felt by QR as a result of these recommendations would be felt quite quickly. Within two years (the QCA's recommended transition period for internal access agreements) QR would need to amend all existing access prices to align with the QCA's recommendations. This amendment in access charges would necessarily have significant implications for the commercial viability of services provided by QR operators.

Output Focus - QR considers that it is possible to provide protection for third party operators and end-users, without imposing avoidable inefficiencies upon the system. This can be achieved by including in the undertaking a provision that prohibits QR from differentiating prices for the purpose of distorting competition or hindering access within a market. The term market would be defined as per the Trade Practices Act and would cover both the market for rail haulage services (ensuring QR does not give an unfair advantage to QR operators) and the market for the end product (ensuring that QR's use of different prices does not hinder competition within that market). This approach would limit the extent to which QR could differentiate prices where negotiations were occurring concurrently. Further, it would limit price differentiation over time i.e. the requirement that QR not distort a market will apply over time as well as at a specific point in time.

Other Regulatory Regimes - given the QCA's reliance on the arrangements for telecommunications regulation as precedent for its proposed approach, it is worth reviewing in more detail the arrangements that apply in this regime. In fact, it is important to note that market definition is not, in itself, the driver in telecommunications access pricing. Rather, market definition is fundamental to the assessment of alleged anti-competitive conduct under s.151AJ(2) of the Trade Practices Act, as it is to most of the restrictive trade practices provisions in Part IV of that Act. The use of market definition provides the parameters in which to assess the telecommunications market in which a carrier or carriage service provider does or does not have market power and whether in that market or another market there has been, or will be, the effect of a 'substantial lessening of competition'.

Notably, the ACCC takes an output focus to access pricing for telecommunications. For example, ACCC pricing guidelines state that access pricing should not discriminate in any way that reduces efficient competition, should not be predatory, an access price should not be artificially inflated to reduce competition in a dependent market, where an undertaking allows differential pricing the ACCC must be satisfied that such pricing will promote competition and will enhance efficient use of infrastructure, access prices are to be cost based and variance in access pricing is to be permitted across buyers where such variance is commercially determined. The focus is on the output that competition and access not be hindered.

This approach allows commercial negotiation that results in variance in access prices, even where negotiated with two different access seekers at the same time. An output based approach such as this has the flexibility to promote the efficiency of both access provider and access seeker and, to this end, is consistent with the spirit of the national competition policy aim of creating efficient, competitive markets. It is these benefits that QR is also seeking through its access pricing regime.

QR notes also that the approach that it is recommending is the more typical approach for constraining price differentiation within a floor ceiling pricing regime. In particular, it is the approach that has been adopted in other rail regimes such as for RailTrack in the UK.

Rate review - QR accepts the principle that the undertaking provide that all operators be afforded the option of an appropriate rate review clause in access agreements, where sought.

QR intends that rate review clauses can be negotiated on a case by case basis taking into account the specific circumstances surrounding a traffic in areas where reference tariffs do not apply, so that the access charge in an agreement is able to be reviewed to align with the charge that would currently be quoted for that train service.

In all cases QR is strongly of the view that any rate review clause must be symmetrical, with the potential for both rate increases and rate decreases being passed on to operators. It is also important to note that the inclusion of a rate review clause in an access agreement is not obligatory. If an operator does not wish to take the risk of future potential movements in access charges, QR will be prepared to enter into a specified rate for the term of the access agreement. QR considers that in extending the right to a rate review clause beyond operators hauling coal to all access seekers, QR has adequately addressed QCA concerns.

FreightCorp - strongly supports the QCA's findings.

We support several vital measures that would ensure price differentiation that does (or does not) occur is justified. These measures include:

- the publication of the below rail components of all access agreements (both internal and external); and

- the inclusion of a “most favoured nation” (MFN) clause in access agreements.

The QCA’s finding that operators should have the benefit of a MFN clause is particularly helpful to protect an above–rail operator’s competitor serving the same end-market gaining a lower access charge that is not causally based. To enable operators to realise the benefit of most MFN clauses it is necessary that all access agreements be available to the public.

It will be noted that the text of the MFN clause proposed by FreightCorp is not limited to price as price is not the only basis upon which QR can discriminate. Schedule E should include a clear statement as to the content of the MFN clause, which should form part of the base case for each access seeker.

RTBU - the QCA’s proposed amendments (amendment 19) are extremely onerous and should be withdrawn.

Many commercial enterprises choose establish different rates for different classes of customer: offering higher discounts for high volume customers. This is accepted commercial practice in competitive markets. Yet such practices would be effectively banned by the QCA, in terms of its extraordinary and extreme interpretations of ‘price discrimination’.

In effect, QR will not be allowed to operate freely to maximise its (capped) returns from access charges. It seems that QCA wishes to impose different standards on a government business than are standard practice in the private sector – all in the name of enhancing ‘competition’.

In any event, these provisions threaten to peg all of QR’s prices to the lowest prices charged to access seekers, notwithstanding other clauses in the Draft Decision which enable QR to escalate its reference tariffs by (CPI – 1.5%) (QCA Draft Decision, Amendment 67). The QCA’s apparent inconsistencies may simply be the product of oversights in drafting. Alternatively, they may be deliberately discriminatory against QR.

If these clauses are to be retained, they threaten to distract QR’s management with regulatory red tape.

QMC - strongly endorses the QCA’s proposed limits on price differentiation and its recommendations for refinement of QR’s costing manual and auditing process to achieve greater rigour in the attribution and allocation of access costs. These measures should provide sufficient safeguard against discriminatory access pricing within the coal and minerals rail markets.

Queensland Government - the QCA’s proposals have the potential to limit QR’s ability to utilise efficient price differentiation (within the floor and ceiling limits) to ensure optimal utilisation of its network. Leaving aside the lines for which reference tariffs are established the Government believes there is considerable benefit in allowing QR some flexibility within the price floor and ceiling approach to discriminate between markets to maximise utilisation and maintain the viability of the network.

The QCA proposal would penalise QR for actions they may potentially undertake and not for what they actually undertake. It is considered any misuse of price differentiation by QR should be dealt with through the appropriate complaints mechanism.

The Government recognises the QCA’s strict limits on price flexibility are a direct response to stakeholder concerns such flexibility would allow QR to discriminate inappropriately between operators with the same market. Non-discriminatory pricing principles underpin the integrity of the above rail market and the Government acknowledges it is essential to ensure QR’s above-rail operators do not receive advantageous access pricing relative to third party operators. However the markets within which QR may not price differentiate other than on a cost basis have been defined very broadly. It is therefore suggested the QCA allow greater flexibility in the identification of markets defined on a geographical as well as commodity basis.

QCA's analysis

QR has expressed concern that the QCA's proposed limitation that QR can only price differentiate within a market on the basis of cost and risk differences, regardless of whether the traffics are directly competing, is unduly restrictive and lacks clarity. Similarly, RTBU argued that the QCA has effectively precluded QR from charging different rates for different classes of customer. This is not the case as the QCA's proposal in the Draft Decision is that QR can price differentiate within a 'market' based on cost and risk differences. The onus is on QR to justify those price differences.

QR has queried the QCA's proposed defined markets, arguing they are too broad. In defining markets in the Draft Decision, the QCA was seeking to emphasise the importance of QR being able to justify different prices for different traffics. For example, where different markets were served, whether because of product, service quality or geographic dimension, then QR would be required to justify its approach.

As such, the QCA does not consider the example QR raised of bulk land-fill garbage and the haulage of sugar is helpful as they would not be considered as being in the same 'market'. Under the proposed arrangements, QR would merely be obligated to justify its price differences by establishing the traffics were in different markets.[1]

However, the rationale behind the QCA's proposal for specific markets was to prevent QR effectively distorting competition in either above-rail or end-user markets by narrowly defining the products that it hauls for the purpose of price differentiation. This could justify, for example, two different charges applying to similar products in a way that would distort competition in an above-rail or end-user market.

In addition, the QCA disputes QR's argument that markets have been specified without reference to normal market definition tests. For example, there is ample authority for transport markets to be defined in terms of an origin-destination combination for a product. However, for clarity, the QCA proposes to refer to 'traffics' in a geographic area instead of 'markets' in order to clarify the matter and to alleviate QR's concerns.

Nevertheless, QR has proposed to supplement the limits on price differentiation with an obligation not to distort competition or hinder access in a market. The QCA supports the addition of the principle that QR must not price so as to distort competition in a market (be it an above-rail market or an end-user market). In practice, the QCA considers there is little difference between the two approaches.

The Authority notes that high transaction costs of themselves could distort competition in an above-rail or end-user market. For example, the QCA is concerned that, for many traffics, the cost of an arbitration could render third party access not being practically available to operators and, as such, by defining particular markets, the QCA was trying to prevent QR exploiting this to the advantage of its above-rail business groups. The QCA notes the practice of vertically separated access providers in other jurisdictions to adopt very simple access charge arrangements. Whilst it is not the Authority's intention to impose rigidity on QR's pricing structure, the Authority considers that QR should be required to justify that its access charges do not breach its proposed test.

[1] QR also questioned how two different origin/destination combinations within the same region might be compared for the purposes of the QCA's proposed limits on price differentiation. In response, if a given price per '000 GTK was charged from Brisbane to Rockhampton, then the QCA would expect that a similar approach be adopted for a Brisbane to Mackay haul (for the same product) unless there was some underlying justification for the change in the Rockhampton-Mackay leg. This is similar to QR's current practice.

It is also important that the requirement to price consistently be subject to the obligation not to distort competition in above-rail markets. This is because access charges could be structured so as to be consistent but nevertheless may distort competition in above-rail or end-user markets.

QR is also concerned that the QCA's approach constrains QR's ability to vary prices over time to take account of changing market circumstances. The QCA recognises that, if market circumstances change to alter the competitiveness of road in comparison to rail (for example, a change in diesel prices or in the road usage allowance), QR should be able to respond to this in the context of its access charges. In contrast, innovation in the delivery of a third-party operator's train services would not constitute a change in market circumstances. Accordingly, the QCA suggests that the justification for price differentials over time be expanded to include cost, risk or market circumstances changing. However, this would still require QR to establish why the third-party operator's traffic is a different traffic in relation to its own in order to justify the change in price. This in turn raises the issue of rate review.

Rate Review

The potential for rate reviews arises in three contexts:

- the proposed 'like train path' arrangements;
- the appropriateness of rate review arrangements beyond the 'like train path' proposal; and
- the appropriateness of mandatory rate reviews for QR's internal services.

It is important to recognise that the rights outlined in the Draft Decision associated with the like 'train path' only become operative when a third party operator becomes aware of a more attractive pricing arrangement for another operator. Since in cases other than coal, access contracts are likely to be commercial in confidence, then it will be relatively rare that this provision actually assists third party operators. Nevertheless, the Authority maintains that it provides an important signal to the above-rail market. Accordingly, the Authority considers such a right should be included in an approved undertaking for third-party operators.

The QCA accepts in principle FreightCorp's view that a rate review ('most favoured nation') clause should not be limited to access charges as this is only one basis on which QR would be able to discriminate between operators. However, in practice two sets of arrangements could only ever be considered in their entirety. With regard to FreightCorp's point about publication of agreements, the QCA's position on the disclosure of below-rail aspects of all agreements (internal and external) for the coal sector is discussed in Chapter 3.

QR argued in its submission that rate review arrangements ought to be symmetrical (that is, with the potential for both rate increases and decreases to be passed on to operators). The Authority supports this proposal subject to the entitlement to a 'like train path' adjustment being recognised irrespective of whether the access agreement allowed for rate review arrangements. A review to market would be conducted on the same basis as was proposed in the Draft Decision (with QR bearing the onus of proof to demonstrate the reasons why an increase in access charges would be justified). The outcomes of any rate review would also have to comply with the Undertaking - in particular the obligation not to distort competition in an above-rail market.

QR's access charging arrangements for non-coal traffics are evolving. Accordingly, it is likely that further refinement of those charges will occur in the period following the finalisation of the Draft Undertaking. The QCA was concerned that the latitude afforded to QR in the Draft Undertaking for access arrangements negotiated at different times could be exploited for anti-competitive ends by QR. Consequently, it is proposed that QR be subject to a requirement that, where it charges a price for a traffic that operates on its network that is higher than applies to a QR above-rail operator for a similar traffic (in terms of product and geographic region), it be obliged to raise its internal price accordingly in the absence of a cost or risk justification. The 'like train path' and rate review arrangements would also be available to QR's above-rail business groups. This is consistent with the Authority's desire to avoid distorting competition in an above-rail or end-user market.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that:

1. **price differentiation is subject to a test in which all railway operators for a traffic in a geographic area would be subject to price differentiation on cost and risk differences or market circumstances changing (whether or not they are competing head-to-head) with QR bearing the onus of justifying price differences;**

2. **QR is required to set access charges in a way that did not distort competition in an above-rail or end-user market and does not hinder access;**

3. **a principle is included that price differentiation should not distort competition in an above-rail or end-user market nor hinder access within a market;**

4. **operators have the option of rate review arrangements in their access agreements;**

5. **operators have the option of rate review provisions in access agreements if an operator is able to demonstrate that QR has sold a like train path to another operator for a lower price than applies to that operator; and**

6. **QR has an obligation to ensure its own traffics pay access charges that are as high as apply to third party operators for similar traffics.**

5.2.3 Rail infrastructure utilisation

Background

The QCA proposed QR's Undertaking should clarify the basis upon which QR would expand its network, such that the assessment of the commercial justification for expansions of the network should focus on the net additional revenue expected to be earned.

Stakeholder views

> **QR** - provided QR is not hindering access to its below rail services, or inappropriately favouring its above rail group over other third party operators, obligations regarding its investment decisions or evaluations are not the province of the access undertaking, and the relevant provisions of the QCA Act (s119) provide sufficient protection for access seekers.

QCA analysis

QR indicates that as long as it does not breach s104 or 125, s119 of the QCA Act adequately protects third party operators in respect of expanding rail infrastructure. However, s119 is couched in general terms and is only triggered by the existence of an access dispute. The QCA sees merit in an Undertaking clarifying the basis upon which expansion of the network would be undertaken.

Accordingly, the QCA remains of the view that QR should clarify its proposed approach for the extension of rail infrastructure in the context of the Undertaking.

> ***QCA's position***
>
> **The QCA considers it appropriate to amend the Draft Undertaking such that sub-cl 5.1.3 provides that QR's assessment of the commercial justification for expansions of its network should focus on the net additional revenue it expects to earn.**

5.3 Pricing Limits

Background

The appropriateness of pricing limits

The Draft Undertaking established a constrained market pricing or 'floor/ceiling' approach to the setting of access charges. Incremental costs would provide the lower bound and stand-alone costs, the upper bound, under this pricing methodology.

The QCA proposed QR's stand-alone cost definition be amended to reflect those costs that would be incurred by an efficient network provider and its incremental cost definition be amended to reflect the costs that would be avoided by such a network provider.

For QR's lines supported by CSO arrangements, the QCA argued there would be little difference between the sum of incremental costs of train services operating on a line and the incremental cost of the line itself. Consequently, the Authority proposed the appropriateness of access charges should not focus on incremental cost but rather the relativities with other charges pertaining to the relevant market. This was provided no traffic nor combination of traffics was required to pay more than its stand-alone cost. In effect, QR would be obliged to observe the limits on price differentiation irrespective of whether the resulting access charges cover the incremental cost of the individual train service.

Requirement for a more prescriptive pricing approach

The QCA argued that as QR's proposed pricing approach only established floor and ceiling limits, it creates uncertainty for access seekers in negotiating access agreements. Nevertheless, the Authority expressed concern about prescribing a methodology for determining access charges. One alternative in markets where rail is subject to intermodal competition is the Competitive Imputation Pricing Rule. The QCA noted concerns with the practical and efficacious implementation of this pricing rule and suggested there may be merit in the Authority setting access charges for relatively homogenous traffics via the reference tariff mechanism, which is considered in section 5.4 below.

Stakeholder views

The appropriateness of pricing limits

QR - notes that to charge an operator less than the incremental cost of the individual train service would be a breach of the undertaking and would therefore attract the consequences of such a breach. This is because the terms of the Draft Undertaking state that an access charge for an individual train service will not fall below the level that will recover the expected incremental cost of providing access for the individual train service, and this provision applies equally for charges for third party operators and QR's above rail operators.

To commit such a breach in the undertaking would invoke provisions of the QCA Act, which specify remedies. Therefore, there is already a provision in place to ensure that QR applies the terms of the undertaking in the manner proposed by the QCA. As such, QR does not consider there is a requirement for the undertaking to restate these consequences, or to specify further consequences associated with a breach of the undertaking.

RTBU - imposing pricing limits which restrict QR to recovering from access charges only those costs of a hypothetical 'efficient network provider providing access' might seem attractive to the QCA because it enables the Authority to make judgments which can cap QR's revenues and lower the prices charged to access seekers – given the QCA's apparent advocacy of the idea that a 30% cut in freight costs via an access regime will promote economic development.

Use of MEERA valuations would leave it open for the QCA to further restrict the maximum revenues which QR could earn because it was incurring high overhead costs. It could also (by definition) preclude QR from recovering the accounting expenses it might incur if it adjusted asset values to reflect the impact of technological change on MEERA values.

Given that the QCA's determination are likely to impose inefficiencies on QR's operations, it is suggested that a specific exemption from the above determination be included to allow QR to recover the costs of complying with the QCA's requirements. To ensure full transparency, QR's costs of complying with the QCA's regulatory requirements (including costs incurred to date) should be separately calculated and reported – and QR should be allowed to add these to any reference tariffs determined by the QCA.

RTBU's has fundamental concerns with the estimated inefficiency in the maintenance of QR's coal corridors of 15% (amendment 47). This is outlined in 12.2.

ARTC - is concerned that the application of the stand-alone revenue limit does not support the legitimate business interest of the access provider in that it must provide sufficient incentive for necessary investment in the network.

Requirement for a more prescriptive pricing approach

FreightCorp - in addition to the QCA's concerns about the Competition Imputation Pricing Rule (CIPR), FreightCorp has the following problems:

- a pre-requisite for CIPR is that the alternative mode of transportation is a perfect substitute for a rail access seeker. This is a very restrictive assumption and is further undermined to the extent there is product differentiation (as would be expected in rail services) and regulated pricing in some components of the substitute product sector;
- CIPR limits the returns to an innovative (demand increasing) entrant; and
- CIPR assumes that the components of the total rail service can easily be divided into above rail and below rail features. Ring-fencing such arrangements will be especially difficult, and will cause additional problems where subsidies are provided to the incumbent rail operator.

Given these difficulties, while it is legitimate to take into account price of substitutable services, we would caution against the use of this methodology in isolation. We would concur with QCA's view that it would be desirable to set reference tariffs for these services, but suggest that the QCA may wish to consider alternative methods rather than heavy reliance on the CIPR model.

QCA's analysis

QR argues that the QCA's proposal in the Draft Decision, that QR be obliged to observe the limits on price differentiation irrespective of whether the resulting access charges cover the incremental cost of the individual train service, is unnecessary as there is already a provision in place to ensure QR does this. However, it is not clear what right a prospective third-party operator would have in the absence of specific arrangements being contained in the Undertaking.

Accordingly, the QCA has not changed its position on this issue as it would appear that, irrespective of a breach of the Undertaking, the provision should be observed in the context of setting the same prices for entrants as currently apply to QR.

ARTC have expressed concern that the stand-alone revenue limit does not provide sufficient incentive for necessary investment in the network. It should be noted that the incremental cost of capacity which is paid by operators, even for CSO traffics, include an element that reflects track occupancy, based on the incremental cost of expansion. Incorporating the incremental cost of expansion of the network in the access charge promotes the efficient use of capital and system augmentation. In summary, the problem identified by ARTC should not arise if every user is paying incremental costs.

In response to RTBU's concern, it should be noted that the QCA has made allowance for QR's regulatory compliance costs in calculating revenue limits. These costs have been reflected in an adjustment to the regional and system-wide costs, discussed in Chapter 12 of the Final Decision.

To remove any ambiguity in the Undertaking, the QCA has proposed a re-definition of stand-alone and incremental costs to make them consistent with the QCA's proposed amendments in relation to revenue adequacy. The proposed definitions place an emphasis on the efficiency of operations and the efficient level of assets actually required to provide the service(s).

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that:

1. **QR is obliged to observe the limits on price differentiation irrespective of whether the resulting access charges cover the incremental cost of the individual train service;**

2. **the definition of incremental cost reads "incremental costs mean those costs of providing access, including capital (renewal and expansion costs), that would not be incurred if the particular train service or group of train services (as appropriate) did not operate. Incremental costs are considered in the context of efficient operations and an efficient level of assets actually required by QR, as network manager, to provide the service(s)"; and**

3. **the definition of stand-alone costs reads "stand-alone costs mean those costs that would be incurred if the relevant train service or combination of train services (as appropriate) was the only train service or group of train services provided access by QR. Stand alone costs are considered in the context of efficient operations and an efficient level of assets actually required by**

QR, as network manager, to provide the service(s)".

5.4 Reference tariffs

Background

The QCA identified the key consideration in the development of reference tariffs for non-coal services as whether the above-rail benefits from increased price transparency for a relatively homogenous set of below-rail train services would justify the associated intrusion into QR's operational autonomy.

The QCA argued reference tariffs ought to be established for the services most likely to attract interest from third-party operators, specifically traffic on the Mt Isa line and intermodal traffic on the North Coast line.

To protect the integrity of the above-rail market, the QCA proposed to reserve the right to require QR to submit reference tariffs for other services within three months of a request by the QCA. QR would be obliged to comply with any request for information to enable the QCA to assess those reference tariffs.

Stakeholder views

QR - given the potential regulatory intrusiveness associated with the reference tariff concept, QR does not consider it appropriate to give the QCA the power under the undertaking to require QR to develop reference tariffs, if QR does not believe such development to be required. The real issue for the QCA should be whether QR is hindering access or distorting competition for its services through its pricing decisions. QR considers that where a pricing mechanism has been approved in an undertaking, and access pricing for the traffic of a particular product has been occurring (or will be potentially occurring) under this approved methodology, then this mechanism should be considered to satisfy the requirements of the QCA Act. In approving the pricing mechanism in the first instance, the QCA will have indicated its appropriateness. The introduction of reference tariffs should therefore typically be the prerogative of QR, with consultation with the QCA.

In the event, however, that QR has not been pricing access in accordance with this approved methodology, this is likely to be sufficient reason for the QCA to require the introduction of reference tariffs. Therefore, QR considers that the power for the QCA to require the development of reference tariffs should only occur where:

- there is evidence of significant demand by third party operators for access for a particular type of train service; and
- there is evidence that QR has not been pricing access for that train service in a manner consistent with the requirements of the undertaking.

QR acknowledges that, to facilitate this mechanism, the undertaking does need to enable the QCA to gather the evidence referred to above.

QCA's consideration of reference tariffs - QR believes that, if further reference tariffs are to be submitted to the QCA in the future, either of QR's volition or on the requirement of the QCA, it is important that the undertaking be more explicit regarding the issues that the QCA consider in deciding whether or not to approve those reference tariffs. In this regard, QR believes that the only criteria for approval of reference tariffs is compliance with the pricing principles in the undertaking.

To go beyond the issue of whether or not the tariffs comply with the pricing principles, the QCA must make a decision regarding where, within the floor - ceiling pricing constraint, the access charge should be set. In its Draft Decision, the QCA itself has acknowledged that it is in a less informed position than QR in relation to the choice of where, within the floor –

ceiling constraint, the price should be set. As a result, the QCA has acknowledged that it would be reluctant to make such a choice.

QR would be less concerned regarding the ability of the QCA to require it to submit reference tariffs, if the undertaking provided certainty that the only basis the QCA could reject a reference tariff was that it did not comply with the pricing principles established in the undertaking.

FreightCorp - strongly supports the QCA's findings.

Given FreightCorp's experience in negotiating with QR, in the absence of an obligation on QR to provide reference tariffs for other services within a specified period of time, QR will have both the incentive and ability to delay reaching agreement. This will raise third parties' transaction costs and reduce their ability to compete.

ARTC - supports a requirement for QR to develop reference tariffs for services other than the coal network.

When rail competes intermodally for its business with respect to non-coal services, it may be more appropriate for QR to develop market-based tariffs. This may make pre-market development of tariffs inappropriate. Nevertheless, the QCA should consider the interests of all parties (and the public interest) in its assessment of tariffs for non-coal services.

PCQ - strongly supports the QCA's proposed methodology to provide separate reference tariffs for individual rail systems. This must be a key tenet in determining any below rail tariff. The alternative of providing a general tariff across all the systems would result in an effective subsidisation of some rail systems at the expense of other systems. This could result in a misallocation of resources leading to a less than optimum system efficiency.

The purpose of providing a competitive rail service is to ensure costs are minimised and efficiencies maximised. It would not make sense to start with a below rail tariff structure that used lower cost systems to subsidise higher cost systems.

QMC - the proposed four-tiered structure of reference tariffs will assist contestability by sending the correct signals to prospective train operators about the costs of entry to the market.

While QMC has confidence in the QCA's calculation of the reference tariffs, we would have preferred it to be supplemented by a building block approach to the determination of allowable access revenues. Such an approach would have been more readily understood and replicated than the discounted cash flow methodology proposed by QR and accepted by the Authority.

As a consequence, QMC believes there needs to be more detail provided than proposed in the Draft Decision in order to make the methodology more understandable, and to provide established and prospective access users with a greater level of confidence in the reference tariffs and in departures from them.

QCA's analysis

The QCA proposed in the Draft Decision that reference tariffs ought to be established where the benefit to the competitiveness of the above-rail market from increased pricing transparency for a relatively homogeneous set of train services justifies the intrusion into QR's operational autonomy. To achieve this, the QCA proposed that it should reserve the right to require QR to submit additional reference tariffs for services other than those outlined in Schedule G within three months of being required to do so by the QCA, and that QR must comply with any related information requests by the QCA.

QR has objected to the QCA's proposals on the grounds that, provided QR meets the test of not hindering access nor distorting competition, the introduction of reference tariffs is QR's prerogative, in consultation with the QCA. It believes the QCA should be limited in its power to require the development of reference tariffs to situations where there is evidence of significant demand by third-party operators and where there is evidence that QR has been pricing in a manner that is inconsistent with the requirements of the Undertaking.

The QCA does not accept QR's view that the QCA should not have a right to request the development of reference tariffs. Given QR's vertically integrated structure, the ability to request the development of a reference tariff is important in ensuring there is sufficient level of transparency with respect to QR's pricing. Ultimately, QR is a vertically integrated operator and, as such, it may not have the incentive to set access prices for its above-rail groups on a competitive basis.

However, the QCA acknowledges QR's concerns regarding the QCA's capacity to require reference tariffs. The QCA stated in the Draft Decision that it considers the key consideration in the development of further reference tariffs is whether the benefit to the competitiveness of the above-rail market from increased pricing transparency justifies the intrusion into QR's operational autonomy. It is not the QCA's current policy to request reference tariffs where there is no interest from access seekers. For clarity, the QCA proposes that any request for the development of a reference tariff would be done after consultation with QR and, further, the QCA must be satisfied that there is a sufficient level of interest from access seekers to justify the request (for example, a request from a third-party operator or an end customer to do so). However, the QCA accepts that specific reference to such a threshold was only mentioned in the analysis section of the Draft Decision rather than the QCA position and therefore proposes that this requirement be formally recognised in the Undertaking.

QR also argues that the Undertaking should be more explicit regarding the basis on which reference tariffs will be assessed by the QCA. Its view is that compliance with the principle that it not distort competition nor hinder access within a market should be the only consideration. The QCA accepts that this principle should be taken into account in assessing reference tariffs, however, the QCA does not accept that this will be the only factor to consider.

ARTC supports a requirement for QR to develop reference tariffs for services other than coal and has suggested that market-based tariffs, set to promote market growth by allowing the market to assess the value of the service, may be appropriate where rail competes intermodally. In this case, setting reference tariffs prior to third-party interest is not feasible. The QCA acknowledges that the legitimate interests of both QR and access seekers, as well as the public interest, will need to be taken into account in the context of setting reference tariffs.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that QR is required to submit reference tariffs for other services within three months of being required to do so by the QCA and is obliged to comply with any request from the QCA for information to enable the QCA to assess those reference tariffs.

Before the QCA requested QR to submit further reference tariffs, it would need to:

1. **be satisfied that the benefit to the competitiveness of the above-rail market from increased pricing transparency for a relatively homogenous set of train services justifies the intrusion into QR's operational autonomy; and**

2. **consult with QR.**

When reviewing reference tariffs submitted by QR, the QCA must

have regard to:

3. **whether the reference tariffs are likely to distort competition in an above-rail or end-user market(s); and**

4. **whether the reference tariffs are likely to hinder access within a market.**

5.5 Cost allocation

Background

The Draft Undertaking proposed that QR would submit a Cost Allocation Manual to the QCA following finalisation of the Undertaking. However, on the request of the QCA, QR submitted a Manual for consideration in December 1999. The QCA released a Request for Comments Paper *QR's Draft Undertaking – Costing Manual*, discussing the draft Manual and seeking responses from interested stakeholders. In addition, cost allocation was the subject of a working group meeting.

The adoption of the Manual by QR plays an important role in providing confidence to customers and above-rail operators that QR is not gaining an inappropriate commercial advantage over competitors through its vertical integration and further that customers are not being required to pay excessive access charges.

Stakeholder views

> **ARTC -** supports the requirement for such a manual. It should provide sufficient detail to enable third parties to have confidence that available pricing on any segment will be competitively neutral with pricing available to QR's above rail business groups. The QCA assessment would provide a 'guarantee' to the industry that it can be confident the principles described in the manual actually achieve this outcome. The use of approved reference tariffs would provide an additional degree of assurance in this regard.
>
> **FreightCorp -** agrees with the QCA's assessment. However, the use of reference tariffs that are regularly assessed by the QCA to some extent removes the need for the cost allocation manual as it currently stands.
>
> FreightCorp questions the level of transparency that the cost allocation manual provides to external stakeholders. It is our view that it does not aid transparency to any great extent in its current form.

QCA's analysis

FreightCorp argues that the proposed approach in the Cost Allocation Manual does not contribute significantly to greater transparency. However, the allocation of costs for the purposes of reference tariffs is clear by virtue of the Costing Manual and the allocators proposed by the QCA for non-maintenance related below-rail operating costs. For services where no reference tariffs apply, the Manual provides the basis upon which costs are separated between QR's above and below-rail operations. The integrity of this separation is critical to ensuring that QR's prices are the same for its own services and those of its competitors.

5.5.1 Timing of finalisation of Manual

QR, FreightCorp and Stanwell provided comments supporting the finalisation of the Costing Manual following the conclusion of the QCA's assessment of the Draft Undertaking. The QCA has not changed its position that the Costing Manual should be finalised as soon as possible following the release of the Final Decision. The Costing Manual will form a schedule to an approved Undertaking.

5.5.2 Transparency

Background

The QCA considered the purpose of the Costing Manual is to provide interested parties with confidence in the integrity of the above-rail market and to provide information relevant to the determination and evaluation of access charges.

Bullpin Pty Ltd considered QR's assignment of costs and assets between its above and below-rail activities to be sound. However, Bullpin advised that the transparency of the cost allocation arrangements required greater attention. Accordingly, the QCA proposed a number of enhancements to the Costing Manual.

Stakeholder views

> *Level of prescription*
>
> **QR** - accepts most of the QCA's recommendations regarding the content of the Costing Manual.
>
> The exception to this is the QCA's recommendation that telecommunications costs be assigned to all business groups (other than below rail groups) on the basis of the market price of the services consumed by those business groups.
>
> It essentially superimposes an element of internal trading based allocations over the general ledger approach that the QCA has already recommended as being acceptable for the purpose of the Costing Manual, and brings with it all of the problems that QR has previously identified as relating to using internal trading as a cost allocation approach.
>
> QR is, however, prepared to accept the allocation approach for telecommunications costs and assets that Mr Bullock recommended in his report to the QCA.
>
> **FreightCorp** - the use of reference tariffs that are regularly (ie every few years) reviewed by the QCA would give FreightCorp a reasonable degree of confidence that the appropriate rates were being paid for access. However this comfort extends from the assumption that the QCA will have total access to QR's accounts as well as being able to make an unfettered assessment of the level of efficient costs that ought to apply. If this is not the case, then FreightCorp would be most concerned at the current nature of the Costing Manual.

QCA's analysis

QR does not accept the QCA's proposed approach of allocating telecommunications costs to all above-rail groups using a commercial pricing approach. QR argues that this would introduce internal trading allocations which is inconsistent with the approach adopted elsewhere.

The QCA recognises QR's concerns on this matter. The QCA accepts that it is reasonable for telecommunications costs to be divided equally between above and below-rail for coal in the short term. However, the QCA considers that a cost model should be developed for the allocation of these costs as part of the finalisation of the Costing Manual to more accurately reflect the value of the telecommunications services consumed by QR's business groups.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that the Costing Manual provides for:

1. **default allocators for corporate overheads;**
2. **the creation of additional account codes to more accurately reflect the split of costs and assets relating to declared and undeclared services;**
3. **telecommunications costs to be divided equally between above and below rail for coal;**
4. **QR's four Central Queensland coal systems to be treated as geographic regions in their own right;**
5. **the more structured use of work orders;**
6. **the netting off of 'like for like' cost recovery type revenue items against the relevant cost items; and**
7. **the assignment of corporate service costs to levels appropriate to where the costs are incurred rather than the Group General Manager level.**

5.5.3 Approaches to cost allocation – internal trading or ledger

No stakeholder comments were received. Consequently, the QCA has not added to the views it expressed on this matter in the Draft Decision.

5.5.4 Actual or efficient costs

No stakeholder comments were received. Consequently, the QCA has not added to the views it expressed on this matter in the Draft Decision.

5.5.5 Financial reporting

Background

The QCA proposed QR commit to report to the QCA within the first half of each financial year, in respect of its previous financial year, a statement of assets, a statement of earnings before interest and tax and a cash flow statement aggregated for:

- the declared services; and
- operations on the Blackwater, Goonyella, Newlands and Moura coal systems.

The financial reports should be prepared using generally accepted accounting principles and in accordance with QR's normal external reporting format.

For the coal systems, the QCA argued the publication of detailed cost data would be unnecessary for price assessment purposes given the transparency that will arise from the publication of reference tariffs

The QCA proposed for services for which access charges are based on stand-alone costs, to provide additional relevant information to interested parties, asset values and depreciation should be published for relevant assets where values for pricing purposes depart from those published in financial statements.

Stakeholder views

Level of disaggregation

QR - in considering the requirement to provide a cash flow statement, the significance of below rail services forming a part of a larger organisation cannot be ignored and, as a result, places substantial limitations on the usefulness of information that can be gathered from such a cash flow statement.

The primary purpose of a cashflow statement is to allow an assessment of an organisation's liquidity. In this context, the relevance of a cashflow statement for a business unit within an organisation is questionable. In addition, it is useful to discuss each of the major elements of a cash flow statement, and the information that stakeholders would receive in the context of a cash flow statement prepared for a segment of QR's business:

- Opening and closing cash position: QR operates from a single bank account for the entire organisation, and therefore does not have an opening and closing cash position for an element of its business such as below rail services, or central Queensland coal region. In order to develop an opening and closing cash position for below rail services, QR would need to allocate QR-wide cash balances according to a relatively arbitrary measure such as total assets or total expenditure, both of which are provided through the statement of assets and statement of EBIT. Therefore, there is no additional information provided to stakeholders through allocating this item.

- Cashflow from Operating Activities: Internal transactions are 'paper' transactions rather than movements in cash, therefore the only way in which QR would be able to derive this information is by allocating total QR cashflows to above and below rail services (and within below rail services) in accordance with earnings before depreciation, interest and tax (EBDIT). Once again, this information is readily available from the other statements that QR intends to publish, and will not provide any additional information to stakeholders.

- Cashflows from Financing Activities: The QCA has already accepted that, given QR finances its activities as an integrated organisation, there is little additional information to be gained from an allocation of cashflows from financing activities.

- Cashflows from Investing Activities: Cashflows from investing activities is the one area where a significant portion of the cashflow can be 'identified' as below rail or above rail, rather than allocated to below rail or above rail in accordance with an arbitrary measure. Further, while the other statements provided will identify the change in QR's asset values from year to year, QR acknowledges that stakeholders may see some benefit in having access to more specific information regarding QR's investment cashflows.

As a result, in addition to the provision of a statement of assets and a statement of EBIT, QR is prepared to also develop and publish a statement of investments for below rail services that are the responsibility of Network Access, and within this, separately identify the statement of investments for the central Queensland coal system.

Use of Generally Accepted Accounting Principles - QR does, and will continue to, prepare its financial statements in accordance with generally accepted accounting principles (GAAP). However, in the context of the preparation of financial statements for the below rail element of QR's business, the Costing Manual provides the primary guidance for the allocation of QR's recorded costs to above or below rail services (and, within below rail services, to the central Queensland coal region compared to the remainder of the network).

QR is happy to accept a recommendation that:

- QR's financial statements will be developed in accordance with GAAP; and
- below rail financial statements will be derived from QR's financial statements in accordance with QR's Costing Manual.

Format of Financial Statements - QR considers it appropriate that the statement of assets, statement of earnings before interest and tax and statement of investments reflect the format of the statements from which they are derived, that is the balance sheet, profit and loss statement and cashflow statement.

RTBU - the Draft Decision plainly errs in prescribing that QR should prepare reports to the QCA prepared in accordance with 'generally accepted accounting principles and in accordance with QR's normal external reporting format'. The term 'generally accepted accounting principles' has not been formally defined by standard setting bodies. However, to the extent that the term 'generally accepted accounting principles' is used in Australia, it is usually taken as referring to the set of procedures prescribed by Statements of Accounting Standards, and other authoritative pronouncements issued by the Australian professional bodies. QR currently employs different asset valuation procedures prescribed by the Queensland Treasury, and follows disclosure requirements set out in Queensland legislation, so arguably QR could not be presently described as complying with 'generally accepted accounting principles'.

Stanwell - in addition to the amendments proposed by the QCA for paragraph 3.3(b) of the Draft Undertaking in relation to accounting arrangements, SCL considers that QR should be made to separately disclose its costs of complying with the Authority's regulatory requirements. In the absence of such a requirement, there seems little to prevent QR from including such regulatory compliance costs in its general operating costs and seeking to pass these on to users at the next regulatory review date. The problem is exacerbated by the relatively low value for the "X" factor in the price cap proposed for QR. To prevent QR from padding such regulatory compliance costs, they could be monitored and benchmarked by the Authority.

QR should also be compelled to publish details of all material discrepancies between its financial statements for external reporting and for pricing purposes. These could be in the Notes to their Annual Accounts.

Jericho Shire Council - the QCA is demanding significantly more detailed publishing of QR accounts than is required for other corporations. This will jeopardise QR's own business, to satisfy an anti-public sector prejudice in the QCA and the interests of prospective third-party rail operators.

QCA's analysis

QR has queried the relevance of providing a cash flow statement for a business unit within a vertically integrated organisation as the primary purpose of such a statement is to allow an assessment of an organisation's liquidity. QR argues that it is only the 'cashflows from investing activities' component of a cash flow statement where a significant portion of the cashflow can actually be identified as being either above or below-rail, rather than being allocated on an arbitrary basis. Consequently, in addition to a statement of assets and a statement of EBIT, QR is prepared to develop and publish a statement of investment for below rail services that are the responsibility of Network Access and, within this, separately identify the statement of investments for the central Queensland coal system. The QCA accepts QR's proposal.

The QCA further accepts QR's position that its financial statements be developed in accordance with generally accepted accounting principles (GAAP), but that below-rail financial statements be derived from QR's financial statements in accordance with the Costing Manual. In terms of the format of the financial statements, the QCA considers that this may be resolved in conjunction with finalisation of QR's Costing Manual.

Stanwell have requested that QR's regulatory compliance costs be publicly reported to ensure that QR do not include such costs in its general operating costs and pass them on to users at the next regulatory review date. The QCA considers that this is unnecessary as regulatory costs would be considered in the same context as any other costs for the purposes of the review. These costs legitimately form part of QR's cost base for regulatory purposes. This is considered further in Chapter 12.

Stanwell have further requested that QR publish details of all material discrepancies between its financial statements for external reporting and for pricing purposes in notes to its annual accounts. The QCA accepts that there is merit in extending its proposed approach in the Draft Decision to include all material discrepancies as opposed to just asset valuation discrepancies. Accordingly, the QCA endorses Stanwell's suggestion.

Jericho Shire Council has suggested that the financial reporting suggested by the QCA would jeopardise QR's business. However, it should be noted that QR has accepted the majority of the QCA's proposals on this matter. It is thought extremely unlikely that any of the QCA's proposals will jeopardise QR's business.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that

1. **QR commits to report to the QCA within the first half of each financial year, in respect of its previous financial year:**

   – **a statement of assets, a statement of earnings before interest and tax and a statement of investments, aggregated for the declared services, prepared using generally accepted accounting principles and in accordance with QR's normal external reporting format; and**

   – **a statement of assets, a statement of earnings before interest and tax and statement of investments aggregated for operations on the Blackwater, Goonyella, Newlands and Moura coal systems, prepared using generally accepted accounting principles and in accordance with QR's normal external reporting format;**

2. **QR undertakes to publish all material discrepancies, including asset values and depreciation discrepancies, for those services for which access charges are based on the ceiling of stand alone cost, in the instances where relevant asset values for pricing purposes depart from those published in financial statements.**

5.5.6 Accountability

Background

The QCA proposed the scope of audits of the Costing Manual should be defined in detail in the Undertaking. Given the high-level nature of the Costing Manual, the scope of the audit proposed by the QCA extended to the appropriateness of the allocation process undertaken by QR and the accuracy, completeness and valuation aspects of the accounts that are produced.

Stakeholder views

> **QR** - the Draft Decision identifies that the QCA considers greater specificity is required, and highlights issues that it believes should be specified in the undertaking.
>
> *Appointment of Auditor* - the QCA is inappropriately questioning the integrity of the auditor. In QR's experience, auditors take their role, and their independence in undertaking this role, very seriously. In any case, QR is prepared to have its below rail financial statements audited on an annual basis by an external auditor appointed by QR. If the QCA insists on appointing the auditor to review these statements, the cost of this audit should be borne by the QCA.
>
> *Audit Process* - QR is prepared to accept obligations in relation to the audit process of the type set out in the Draft Decision. However, QR considers that amendments will be necessary to better clarify the auditor's role and powers as well as the process for conducting an audit. These will be incorporated by QR in its revised Draft Undertaking.
>
> The exception to this is that QR does not consider it appropriate that the undertaking specify the consequence of a qualified audit report regarding QR's compliance with the manual. The QCA Act provides for significant penalties for non-compliance with an approved Costing Manual. A qualified audit report itself is likely to give an understanding of the significance of the issues that have led to the qualification.

QCA's analysis

Appointment of the auditor and audit process

QR has indicated it is prepared to have its below-rail financial statement audited on an annual basis by an external auditor appointed by QR. However, the experience in other jurisdictions has emphasised the importance of the regulator having a role in the appointment of the auditor to protect the integrity of the audit process. In addition, the QCA argued in the Draft Decision that, as the need for the audit arises from QR's vertical integration, QR should be required to meet the cost of such audits.

Given the QCA has not changed its position on QR paying for the audits, the QCA considers it is possible to have a process that allows QR a greater say in the selection of an auditor to have some control over costs. This would be subject to the QCA overseeing the selection of the auditor and the matters the auditor will address and that the primary obligation of the auditor would be to the QCA. The process would be along the following lines:

- QR and QCA agree a list of three auditors. Failing agreement, QCA will nominate a number sufficient to constitute a panel of three;
- Each auditor selected to the panel must – acknowledge that if appointed they are to act for the QCA; that they owe their duties to the QCA under the terms of the Undertaking; and that they will accept instructions on the subject matter of the audit from the QCA;
- QR then chooses the auditor to undertake the audit from the list. That auditor will undertake the audit and may be directed by the QCA as to matters that are to be looked at and reported on;
- The report of the auditor is to be given to the QCA with a copy to QR; and
- QR is committed to pay for the audit.

While QR is prepared to accept the obligation in relation to the audit process of the type set out in the Draft Decision, it reserves the right to set out the terms of the audit in its revised Undertaking. The QCA believes it is better if the auditor's role and powers, as well as the process for conducting an audit are clarified in the Undertaking.

Reporting of audits

QR does not accept that the Undertaking should specify the consequences of a qualified audit report regarding QR's compliance with the Costing Manual. The QCA's key concern is to ensure that the fact of a qualified audit report does not prevent robust information emerging from the process. Accordingly, it is critical that the auditor has the capacity to ensure that appropriate information is published.

Nevertheless, the QCA accepts that QR should be able to put forward a qualified audit report so long as it produces any additional information the auditor requires. This is because the QCA can't force QR directors to sign off on accounts they do not accept. However, QR must present all information. If the auditor thinks the accounts do not achieve this, QR must comply with the auditor's requirements regarding publication of notes to the auditor's satisfaction. As such, the QCA has not changed its position that QR must comply with the QCA's requirement in response to a qualified audit report in accordance with the QCA's timeframes.

QCA's position

The QCA considers it appropriate to amend the Draft Undertaking such that

1. **the scope of the audit is defined, such that the auditor examines whether:**
   - **the processes contained in the Manual have been followed; and**
   - **the financial statements represent a reasonable allocation of costs and are consistent with the Manual;**
2. **QR is obliged to present financial statements prepared in accordance with the Manual within 6 months of the end of the financial year;**
3. **these accounts are certified by the Chair and the Chief Executive or the Chair and a Director;**
4. **the following process apply to select the auditor to audit QR's compliance with its Manual;**
   - **QR and QCA agree a list of three auditors. Failing agreement, QCA will nominate a number sufficient to constitute a panel of three;**
   - **each auditor selected to the panel must – acknowledge that if appointed they are to act for the QCA; that they owe their duties to the QCA under the terms of the Undertaking; and that they will accept instructions on the subject matter of the audit from the QCA;**

> – **QR then chooses the auditor to undertake the audit from the list. That auditor will undertake the audit and may be directed by the QCA as to matters that are to be looked at and reported on;**
>
> – **the report of the auditor is to be given to the QCA with a copy to QR; and**
>
> – **QR commits to pay for the audit.**
>
> 5. **it is confirmed the auditor would be provided full access to QR's information systems, with the degree of access forming part of the auditor's report to the QCA;**
>
> 6. **QR is obliged to provide any information the auditor requires within any reasonable timeframe nominated by the auditor;**
>
> 7. **it acknowledges that QR must comply with the Authority's requirements in response to a qualified audit report in accordance with the Authority's time frames; and**
>
> 8. **it acknowledges that an audit may be conducted at any time.**

5.6 Performance regime

Background

QR argued access agreements will incorporate performance standards related to train services and a system of incentives and disincentives would be incorporated to encourage the achievement of such standards.[2] Consequently, there would be no role for public disclosure of performance against benchmarks as above-rail operators would be aware of the necessary information through the operation of access agreements.

In contrast, the QCA argued there would be considerable benefits from public disclosure, in terms of public confidence in the performance arrangements, particularly given QR's vertical integration. A number of stakeholders supported strongly the view that any disadvantage to themselves of public disclosure of contract details would be outweighed by the benefits.

The QCA tabled a list of potential service quality indicators to a Working Group meeting between QR and stakeholders in April 2000, with a view to formulating a preliminary performance regime. Generally, there was a favourable response from industry participants to the proposed suite of indicators, which was presented in the Draft Decision. The QCA proposed that the indicators should be provided for in QR's Undertaking and disclosed publicly on a monthly basis.

The QCA argued that, notwithstanding the opportunity for access agreements to take any position that might be negotiated between parties, it did not consider it appropriate during the first term of QR's Undertaking to nominate penalties to apply to service quality indicators.

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[2] QR's submission to the QCA's Issues Paper *QR's Draft Access Undertaking - Reference Tariffs, Reference Train Services and Rate Regulation*, October 1999.

Stakeholder views

General comments

QR - QR is prepared to undertake public reporting of certain performance indicators.

ARTC - supports the QCA position that key performance measures should be identified in the Undertaking (either in the body or as part of a standard access agreement), although some flexibility to deal with the specific circumstances of a particular operator should be provided for. Standard measures provide a consistent and efficient framework.

FreightCorp - agrees with the QCA's assessment that QR, as network manager, should be accountable for the provision of its below-rail services. However, there is no commercial nor legal imperative for QR to agree to a meaningful regime. If things remain as currently, train operators are unlikely to achieve an outcome that gives them comfort that QR will provide access and use as contracted. There is a role for a centrally-determined performance regime.

The definition of a healthy train

QR – the QCA's definition of a healthy train is different from the definition used by the ARTC and other interstate railway managers. The QCA deems a train unhealthy if it is delayed by the Rail Manager while ARTC designates trains that are delayed by the Train Operators as unhealthy. This difference in definition alone would result in a significant inconsistency between performance reporting by QR as compared to other railway managers, thereby failing to meet one of the key criteria for the development of public performance reporting.

ARTC – While the QCA appears to have replicated ARTC's service quality measures, it has appeared to not fully grasp the underlying principles from which these measures have been derived.

ARTC and its customers make the following commitments regarding service reliability in access agreements:

- a service which enters the network on time and suffers no subsequent delay attributed to the operator can expect to exit the network on time;
- a service which enters the network late or suffers subsequent delay attributed to the operator can expect to exit the network no later than the sum total of these delays, notwithstanding any delay created in affecting a recovery of the service;
- in the case of a service which enters the network late or suffers subsequent delay attributed to the operator, ARTC will use best endeavours to recover the service, notwithstanding obligations made to operators using the network with respect to the first two commitments above; and
- an operator is to use its best endeavours to ensure that its use of the network complies with its train path and is carried out in such a way as to minimise obstruction to the network and ensure use of the network by any other user (as authorised by ARTC) is not prevented or delayed.

To facilitate the monitoring of respective performance, it is necessary to draw a clear distinction between the management responsibilities of the access provider and customer with regard to achieving the required outcome. In an open access environment, a successful outcome is beneficial to both parties.

The need to draw this distinction gave rise to the concept of 'healthy' and 'unhealthy' services. A train is healthy if it has arrived onto the network on time and suffers no subsequent delay attributable to the above-rail operator. If it experiences a delay attributable to the above-rail operator, it is considered unhealthy.

The health of a train is entirely within the control of the above-rail operator and is in no way related to the position of the train in relation to its capacity entitlement. A healthy train can be on its path, or off its path (its lateness may be attributable to below-rail causes (for example, speed restriction)). Similarly an unhealthy train can be off its path, or on its path (it may have recovered its position).

Key performance indicators

QR- A critical issue in this regard is the management and information systems that are adopted by QR for the collection and collation of operational information. QR's current management system is the Freight Management System (FMS), which was developed in the early 1990's in order to meet the requirements of an integrated railway operation, focusing on freight management rather than capacity management.

QR is currently in the process of assessing and developing a new operational management system referred to as the Infrastructure Monitoring, Planning and Capacity Tool (IMPACT). The IMPACT project, if progressed, will provide for the collection and collation of operational information in a manner consistent with that achieved by the Rail Access Management System (RAMS) which is in common use in other Australian rail networks, and which has effectively set the national 'benchmark' for train monitoring systems. QR anticipates that the IMPACT project could be fully implemented and commissioned throughout the QR Network by June 2003.

In this context, the publicly reported performance indicators that QR commits to in the initial Undertaking must be based on data that is available from existing QR systems, and is also available from RAMS (noting that any information that is currently available from RAMS will also be available from IMPACT). Given that IMPACT can not be fully implemented before June 2003, QR cannot currently commit to the reporting of any indicators not available from existing QR systems (but available from RAMS).

While a significant number of the QCA's proposed indicators are likely to be available at a future time, they cannot be derived from QR's current management and information systems. In order to facilitate the provision of useful information to stakeholders within a reasonable timeframe, QR has identified a series of performance indicators providing broadly similar information, that are able to be reported from QR's current performance systems.

However, if IMPACT were to be fully commissioned, it will have greater flexibility regarding the type of performance indicators that can be reported. As a result, it may be appropriate to review the publicly reported performance indicators at that time.

QR- The healthy/unhealthy concept is based on attributing responsibility for each variation to a service's schedule (delays) to either above-rail (operator) or below-rail (manager) reasons. However, this is an oversimplification of measuring the performance of the railway system. The micro actions of operators, particularly on a network operating at or near full capacity, will have a direct impact on the actions of the railway manager (through train control). For example, an operator may have above-rail problems that result in the service being delayed 'x' minutes (not in excess of an agreed tolerance). Train controllers may elect to amend a number of service schedules and perform unscheduled service crossings in an attempt to maximise the efficiency of the network (within the limits of the Access Agreements) and where possible assist the delayed service to return to its original schedule. The above-rail delayed service could result in many consequential unscheduled service crossings throughout the network.

As the healthy/unhealthy train concept is based on attributing the responsibility of all delays to either above- or below-rail reasons, the responsibility of unscheduled service crossings must be determined. The decision to perform unscheduled service crossings is clearly the responsibility of the railway manager via train control. However, in the above example, the unscheduled service crossings were the direct result of a service relayed for above-rail reasons. Therefore, it is difficult to reach agreement on attributing the responsibility of unscheduled service crossings to above- or below-rail reasons, particularly where many consequential unscheduled service crossings occur. In the majority of cases, the primary cause of the consequential unscheduled delays is unclear and could have occurred several hours earlier within a different system.

QR prefers a performance regime that attributes unscheduled crossing delays to an 'unallocated delay' category (events not within the control of, or where the responsibility can't be clearly assigned to either above-rail or below-rail parties). QR has proposed the following performance indicators

Reliability of service

- number and percentage of trains that enter the network outside the agreed threshold;
- number and percentage of trains that enter the network outside the agreed threshold due to below-rail reasons;
- number and percentage of trains that enter the network outside the agreed threshold due to above-rail reasons; and
- number and percentage of trains that exist the network outside the agreed threshold.

Transit time of the service

- number and percentage of trains that experience an individual above-rail delay[3] on the network and exit the network outside the agreed threshold;
- number and percentage of trains that experience an individual below-rail delay on the network and exit the network outside the agreed threshold; and
- number and percentage of trains that experience an individual unallocated delay on the network and exit the network outside the agreed threshold.

Availability of the service

- number and percentage of services cancelled due to below-rail reasons; and
- number and percentage of services cancelled due to above-rail reasons.

Track quality

- track quality measured by a quality index with component measures such as rail surface level, alignment, twist/cross level and gauge variation

Safety

- number of reportable incidents (major/minor as defined in AS 4292).

ARTC - supports the QCA's proposed measures relating to service reliability (which appear to replicate those provided to it by ARTC), subject to revision of the definition of a healthy train.

It should be noted that outcomes, in respect of indicators which makes use of the 'healthy' or 'unhealthy' definitions, are heavily reliant upon the correct identification of the cause of delays. This identification is normally carried out by the train controller and reliant upon advice from the operator (driver). Clearly an incorrect assessment will result in the incorrect commitments being made and may alter the treatment of the train on the network. As a result it is important that the access provider develops a robust set of rules for the classification of delays, which could be done in consultation with users. These rules will also need to be supported by appropriate training.

FreightCorp - the performance regime is something better developed through a reconvened working group; a group chaired by the QCA. The performance regime would be an industry standard document. Schedule E should state clearly that the performance regime will be incorporated by reference. This would form part of the base case for access seekers.

Categories of service

QR - QR notes that the QCA has sought the performance indicators to be published at an aggregate level, but separating the performance of coal and non-coal train services on the network. QR agrees that the service characteristics of coal services are different from many

[3] A delay is an event that causes a train to lose greater than 15 minutes in running time.

other services on the network (particularly timetabled services), and as a result it is warranted to have some disaggregation of performance for markedly different types of services. However, QR believes that the most effective disaggregation of service types is as follows:

- coal and mineral type services; and
- other services (excluding Citytrain services)

As well as representing a better aggregation of services with similar characteristics, this grouping of performance information is readily available from QR's existing management and information systems.

This aggregation can apply to all of QR's public performance indicators with the exception of the track quality indicator. In this instance, the indicator is derived from geographically-based information, rather than service-based information. However, in keeping with the intent of the disaggregation proposed for service-based indicators, QR proposes that the track quality indicator be reported separately for:

- the Central Queensland coal region (incorporating Newlands, Goonyella, Blackwater and Moura systems); and
- the remainder of the network (excluding the Metropolitan system).

QR above-rail and third-party operators

QR - while recognising the QCA's concern about scheduling and train control being provided on an impartial basis to all operators, QR does not believe that separately reporting public performance indicators for QR operators and third party operators is an effective means of measuring this objective. It is highly likely to mislead stakeholders regarding whether or not there is impartiality in the provision of train control.

QR operators will have a wide range of train services operating over the entirety of the network. In contrast to this, at least in the short term, third party operators will have a limited number of relatively homogenous train service types operating in a small number of geographic areas. In addition, there are often likely to be incidents or factors that impact on the service performance for train services only of a particular type (such as high speed passenger services), or in a particular local geographic area.

Frequency of reports

QR - given that the primary performance regime will be incorporated into each operator's access agreement, and that the public performance indicators are intended only as supplementary information, QR considers that the costs associated with collating and reporting these indicators on a monthly basis will be greater than the benefits associated with such frequent reports. Rather, QR proposes that these indicators be reported on a quarterly basis.

Financial penalties

ARTC - agrees with both QR and the QCA that this activity is still evolving in the rail industry and needs to be properly and consistently developed. It is important that any financial implications be set at a level which does not direct the focus away from the 'main game' of producing a quality outcome.

FreightCorp - as part of the performance regime that FreightCorp has suggested to QR, liquidated sums are payable to FreightCorp if QR does not provide that which it has contracted to provide.

QCA's analysis

The performance regime

Service performance indicators allow users and potential access seekers to evaluate the cost effectiveness of the service currently being delivered and increase the accountability of QR in terms of that service delivery. The QCA believes that QR, as network manager, should be accountable for the provision of its below-rail services.

Stakeholders including QR have identified the need for public reporting of performance indicators. These measures will be in addition to those incorporated in access agreements which serve to monitor the performance of QR and above-rail operators against their contractual obligations. Performance has wider implications because of the effect of poor performance on other users of the system and the effect of performance on the possible level of use.

The definition of a healthy train

In the Draft Decision, the QCA developed a preliminary regime with KPIs in the categories of service reliability, transit time, service availability, track quality, safety and billing accuracy. Within the service reliability category, a number of the KPIs made use of the healthy train concept.

The Authority defined a healthy train as one that has experienced no deviation, in excess of an agreed tolerance, from the path in the daily train plan that could be attributed to QR in its role as rail manager. This definition was also adopted in the Train Control Principles for application in the event of out-of-course running. Clearly, under this approach, the health of the train is determined by the actions of the network manager.

Stakeholders identified that the Authority's definition of a healthy train is inconsistent with the definition adopted by ARTC and other industry participants. ARTC considers that a healthy train is one that has arrived onto the network on time and suffered no subsequent delay, within an agreed tolerance, attributable to the above-rail operator. In other words, the health of a train, either on entry to or whilst on the network, is entirely within the control of the above-rail operator. Where such a delay has been experienced, the train is deemed unhealthy.

In addition, ARTC pointed out that its concept of train health is not related to the position of the train in relation to its capacity entitlement. A healthy train can be on its path or off its path, with lateness attributable to below-rail causes such as speed restrictions. Alternatively, an unhealthy train can be off its path, or on its path, having recovered its position.

The Authority considers that the difference in definition is one of emphasis. The QCA framed its definition of a healthy train with a view to establishing a causal link between the actions of the below-rail service provider and the relative performance of a train service. The train was deemed healthy by default if it experienced no delay attributable to the infrastructure owner. In other words, train health is independent of the conduct of the above-rail operator.

Nonetheless, the QCA believes that a key element of the performance regime to apply for QR's coal network is consistency with nationally-established benchmarks. While the formulation of a national performance regime for rail infrastructure is some way off yet, major developments at the national level, such as the determination of classifications and definitions, should be incorporated into the state regimes. In the Draft Decision, the service quality categories proposed are broadly consistent with those adopted by the ARTC and forming part of the Interstate Rail Access Code.

Accordingly, the Authority will revise its definition of a 'healthy' train to conform with the definition applying in jurisdictions elsewhere. Specifically, the QCA will define a healthy train as a train that has experienced no delay (within agreed tolerance) attributable to the above-rail operator, either on entry or whilst on the network. This will necessitate some revisions to the suite of proposed performance indicators.

Key performance indicators

In a Working Group meeting between QR and industry stakeholders held in April 2000, the QCA tabled a list of potential service quality indicators with a view to formulating a preliminary performance regime. QR advised the Working Group that it would consider the list and distribute a proposal to participants shortly thereafter. The QCA, recognising the complexity of arriving at meaningful KPIs, emphasised the importance of this process being completed before the release of the Draft Decision. However, QR later indicated that its preferred position would be included it its submission to the Draft Decision.

In its submission, QR noted that its existing information system, FMS, was limited in the data that could be collected and collated. However, it was anticipated that a new system, IMPACT, could be fully commissioned by June 2003. This would provide access to a more extensive range of information consistent with Rail Access Management System (RAMS) which is a train monitoring system commonly used in other Australian networks.

QR is of the view that, in the initial regulatory period, the publicly reported performance indicators that it commits to must be based on the data available from the existing FMS information system. At this point in time, QR is not prepared to commit itself to the provision of data from IMPACT. However, it is prepared to revise the agreed-upon indicators some time in the future when it has greater flexibility in terms of data capacity.

While the Authority understands the limitations placed upon QR by the existing technology, it believes that QR should undertake all reasonable endeavours to comply with public performance reporting requirements. This may involve the manual recording of information before an automated system becomes available.

In order to facilitate the provision of useful information to stakeholders within a reasonable timeframe, QR has identified a suite of performance indicators, similar to those in the Draft Decision, that the FMS is able to report.

The QCA has reviewed its proposed performance regime in light of QR's proposals and in recognition of the existing technological limitations. The QCA's assessment of these factors follows.

<u>Service reliability</u>

Service reliability indicators identify the extent to which train services operate in a timely and reliable manner. QR contends that the application of the healthy train concept is difficult due to problems with the attribution of delays. As a result, for service reliability indicators, it has proposed to avoid reference to the concept and ascribed delays to three categories:

- below-rail;
- above-rail; and
- unallocated delays which incorporate events not within the control of, or where the responsibility cannot be clearly assigned to, either above- or below-rail parties.

While acknowledging the subjectivity associated with distinguishing the causes of delays, the Authority believes that, in light of its application in key performance measures elsewhere, the concept of the healthy train should be used in the definition of service reliability indicators for QR's network. This is consistent with the QCA's desire to support the establishment of national standards across regimes.

However, the Authority is mindful that the broader role of the performance regime is the improvement of service quality, rather than a focus on the allocation of blame. Consequently, it considers that there is a need for consultation between QR and operators to identify a transparent process to attribute responsibility, particularly in those cases which QR has distinguished as unallocated delays. The identification of prescriptive rules and guidelines will facilitate the consistency of allocations and improve the confidence of both parties in the performance regime. It is important, therefore, that these arrangements have been finalised before financial penalties (see below) are enforced.

The adoption of an alternative definition of a healthy train will change the emphasis of the QCA's proposed service reliability indicators which utilise the concept. The Authority considers that the indicators should be revised to take account of the new definition.

Accordingly, the Authority proposes to adopt the following service reliability measures, which mirror those adopted by ARTC:

- the number and percentage of healthy services that exit on-time, within agreed tolerances;
- the number and percentage of unhealthy services that do not deteriorate further, within agreed tolerances. In these instances, the extent of the lateness on exiting the network is no greater than the total delays that are the result of the above-rail factors which caused the initial unhealthiness of the service;
- the number and percentage of unhealthy services that exit on-time, within agreed tolerances. In these instances, the access provider has fully recovered those above-rail delays which caused the service to be unhealthy; and
- the number and percentage of total services which are operated in a healthy manner.

The Authority understands that these indicators are consistent with QR's existing performance reporting regime and are available from RAMS.

Transit time

The Authority considers that the indicators in this category should reflect the causes of delays on the system.

QR is of the view that system delays can be caused by a wide range of factors. While the QCA had proposed an indicator based on the identification of temporary speed restrictions, QR argued that, aside from being difficult to identify and measure, the impact of these restrictions on train running would be better incorporated as part of an indicator which took account of a wider range of possible below-rail sources of delays.

The Authority recognises this. However, it maintains that there is a need to measure the extent of network speed restrictions. Accordingly it proposes that QR should report the average number of kilometres of track under temporary speed restrictions that prevail during the reporting period.

QR has proposed 3 indicators which specifically allocate delays to above-rail, below-rail and unallocated factors. Each is a reflection of the delays that are the respective responsibilities of the rail operator, the rail manager and some factor, such as the weather, which cannot be assigned to either party. Central to this series of indicators is the concept of delay, which QR has defined as an event that causes a train to lose greater than 15 minutes in running-time.

The QCA accepts QR's categories of delays and the principles on which the indicators are based. However, it believes that a more meaningful definition of a delay specifically relates to the network exit-time as the critical operational objective. Consequently, the Authority proposes to amend the definition of a delay to an event or events that cause a train to exit the network later than the planned exit-time plus any agreed-upon tolerance.

In this context, rather than identifying every delay, many of which are likely to be small, the QCA considers that the indicators should establish a lower bound for those delays which it will register and accordingly has selected 15 minutes for this purpose. For example, if a train had a planned exit-time of 16.25 p.m., and the tolerance agreed between Network Access and the above-rail operator was 5 minutes, the indicator would record if the service exited the network later than 16.45 p.m. (16.25 + 5 minutes + 15 minutes).

QR also discussed the advantages of including an indicator measuring the average time, in minutes, of below-rail delays. However, it did not go so far as to formally propose it. The QCA considers that this indicator, and a similar measure for above-rail delays, should be adopted as part of the performance regime.

<u>Availability of service</u>

In this category, the QCA sought to measure the extent to which allocated paths and capacity entitlements are adhered to. This was to be achieved through an assessment of departures from capacity entitlements and the instances of track possession time overruns.

QR has proposed 2 indicators which identify the unavailability of scheduled services due to above and below-rail factors. In its view, a service will be delayed or cancelled for below-rail reasons if an allocated path is unavailable. Consequently, the average below-rail delay (minutes) and cancellations due to below-rail factors will be an effective measure of service availability. These indicators would also capture track over-runs.

The QCA accepts QR's proposed indicators. However, it considers that the number and percentage of services cancelled due to unallocated factors should be reported as a specific measure to take account of factors such as cyclones.

<u>Track quality</u>

The track quality indicator is a reflection of the sufficiency of the levels of maintenance and renewal of the asset base. QR has supported the inclusion of this indicator in the performance regime.

<u>Safety</u>

This indicator, which defines incidents in accordance with AS 4292, is a measure of the operational performance of above-rail operators in respect of safe-working practices. The QCA agrees with QR that this indicator should not be specific to each operator. The performance of each operator and their specific incidents will be addressed in the context of access agreements.

Billing accuracy

In this category, the Authority sought to measure the reliability of the system that invoices rail operators for their use of the network. QR is of the view that this is unnecessary.

While the nature of complaints may be subjective, the QCA believes that it is important for QR to show that its billing mechanism is reliable. It does not breach confidentialities in regard to operator costs and charges, but simply identifies instances where discrepancies may have arisen. Accordingly, it may be best to assess this measure in the context of its historical trend.

Categories of service

QR has identified that the characteristics of coal services are quite distinct from other network services, such as timetabled services. Accordingly, disaggregation of performance data would be best undertaken on the basis of these markedly different operations. With the exception of the track quality indicator, QR has proposed to separate performance quality data into the following categories:

- coal and mineral type services; and
- other services (excluding Citytrain services).

In the Draft Decision, the QCA proposed to separate the performance reporting data between coal and non-coal operations. However, it agrees with QR's proposal that there is more relevant information to be obtained from this data if these categories are re-defined into more homogeneous service groupings. In particular, the performance of freight operations should be separated from coal and passenger-type services.

Consequently, the Authority is of the view that, with the exception of track-specific indicators, QR should report the KPIs in the following categories:

- coal and mineral-type services;
- freight services; and
- other services (excluding Citytrain services).

The QCA agrees with QR's proposal to report the track quality indicator separately for the Central Queensland coal region and the remainder of the network (excluding the Metropolitan system). This approach would also apply to the temporary speed restriction measure.

QR above-rail and third-party operators

The Authority considers that it is important for QR to promote the fact that scheduling and train control services are delivered in a competitively neutral manner. Separation of performance statistics for QR above-rail and other third-party operators is a means of demonstrating this.

QR identified concerns that this approach may be misleading. However, the Authority believes that these problems can be overcome by comparing like services and examining trends over time, rather than concentrating on the analysis of single statistics.

Frequency of reports

QR has proposed that the KPIs should be reported on a quarterly, rather than monthly, basis. It takes the view that costs associated with compiling more frequent reports are in excess of the benefits to be gained from such publication.

The QCA considers that monthly reporting is an important facet of a centrally-determined performance regime, particularly in the context of assessing trends over time. However, in light of the fact that new information systems will not be fully installed prior to June 2003, the Authority is prepared to accept quarterly reporting until that time.

Financial penalties

The Authority does not consider it appropriate at this point in time to nominate penalties to apply to the KPIs. Rather, focus should be on the collection of relevant data to facilitate the development of meaningful KPIs in the future.

The QCA will revisit this issue in conjunction with the development of the standard access agreement.

QCA's Position

The QCA considers it appropriate to amend the Draft Undertaking such that it provides for the following key performance indicators to be disclosed publicly on a quarterly basis:

1. **the number and percentage of healthy services that exit on-time, within agreed tolerances;**

2. **the number and percentage of unhealthy services that do not deteriorate further, within agreed tolerances;**

3. **the number and percentage of unhealthy services that exit on-time, within agreed tolerances;**

4. **the number and percentage of total services which are operated in a healthy manner;**

5. **the average number of kilometres under temporary speed restrictions that prevail during the reporting period;**

6. **the number and percentage of trains that experience an above-rail delay on the network that is in excess of 15 minutes;**

7. **the number and percentage of trains that experience a below-rail delay on the network that is in excess of 15 minutes;**

8. **the number and percentage of trains that experience an unallocated delay on the network that is in excess of 15 minutes;**

9. **the average time, in minutes, of below-rail delays;**

10. **the average time, in minutes, of above-rail delays;**

11. **the number and percentage of services cancelled due to below-**

rail factors;

12. **the number and percentage of services cancelled due to above-rail factors;**

13. **the number and percentage of services cancelled due to unallocated factors;**

14. **track quality measured by an index with component measures such as rail surface level, alignment, twist/cross level and gauge variation;**

15. **the number of reportable safety incidents (AS 4292); and**

16. **the number of complaints regarding billing accuracy.**

The timing of the publication shall be on or by a date to be agreed with the QCA.