

File Ref: 1276186

15 December 2017

Mr Michael Riches
Group Executive Network
Aurizon Network Pty Ltd
GPO Box 456
Brisbane Qld 4001

Dear Mr Riches

Aurizon Network's 2016–17 revenue adjustment amount application

The Queensland Competition Authority has determined that Aurizon Network has appropriately calculated all of the revenue adjustments proposed in its amended application submitted on 5 December 2017. The QCA has therefore decided to approve Aurizon Network's amended revenue adjustment amount for 2016–17.

The QCA's review of the revenue adjustment is summarised in the attached decision notice. The notice includes a brief overview of the basis of our assessment and our main findings. This is a written notice for the purpose of clause 4.3(n)(i) in Schedule F of the 2016 access undertaking.

If you have any questions about this decision notice, please contact Shaun McLagan on 07 3222 0582 or by email at shaun.mclagan@qca.org.au.

Yours sincerely



Charles Millstead
Chief Executive Officer

cc: Donna Bowman, Network Regulation Manager, Aurizon Network

DECISION NOTICE

Aurizon Network's 2016–17 Revenue Adjustment

15 December 2017

The Queensland Competition Authority (QCA) has made a decision to approve the amended revenue adjustment claim for \$39.11 million that Aurizon Network submitted on 5 December 2017 under the 2016 access undertaking (Schedule F, cl. 4.3(n)(i)). The QCA considers that Aurizon Network has calculated the adjustment amounts in accordance with schedule F, clause 4.3 as required under Schedule F, clause 4.3(m).

Assessment process

The 2016 undertaking provides for Aurizon Network to submit to the QCA an application by 30 September each year to refund or recoup any over- or under-recovery of its allowable revenues (Schedule F, cl. 4.3(h)). The revenue adjustments are the difference between the allowable revenue approved by QCA, plus any allowable adjustments, and the total actual revenue accrued in that year from the AT2–AT5 tariffs.

The undertaking sets out a procedure for the QCA to assess a revenue adjustment claim by Aurizon Network (Schedule F, cl. 4.3).

The QCA will approve the application provided it is reasonably satisfied that the adjustment amounts have been calculated in accordance with clause 4.3 of schedule F (cl. 4.3(m)). Once the adjustment amount has been approved, it will be reflected in the reference tariffs AT2–AT5 two years after the financial year to which the adjustment relates (Schedule F, cl. 4.4).

If the QCA is not satisfied that the revenue adjustment has been calculated in accordance with clause 4.3, it must refuse to approve it (Schedule F, cl. 4.3(n)(ii)). The QCA will then give Aurizon Network a notice saying what Aurizon Network is required to resubmit for the QCA to be able to approve the application (Schedule F, cl. 4.3(n)(ii)).

Through the revenue assessment process, the QCA has closely checked Aurizon Network's application and supporting models on volumes, tariffs and take-or-pay calculations, and the adjustment calculations, against all available information (publicly available and confidentially provided), to determine whether the calculations have been performed in accordance with the 2016 access undertaking.

Aurizon Network's revenue adjustment proposal

Aurizon Network submitted an initial revenue adjustment application to recover \$40.5 million for the 2016–17 financial year.¹ After discussions with QCA staff, Aurizon Network chose to amend its submission to remove the \$1.3 million claimed for Ground Penetrating Radar System (GPRS) costs, reducing the claim to \$39.1 million². The claim includes under-recoveries of \$27.4 million from the Blackwater system and \$16.6 million from the Goonyella system, and over-recoveries for the Moura, Newlands and GAPE systems of \$0.6 million, \$3.7 million and \$0.5 million respectively (see Table 1).

Table 1 2016–17 revenue adjustment amounts (\$ million)

<i>System</i>	<i>Non-electric</i>	<i>Electric</i>	<i>Total</i>
Blackwater	\$19.1	\$8.2	\$27.4
Goonyella	\$12.4	\$4.2	\$16.6
Moura	(\$0.6)	\$0	(\$0.6)
Newlands	(\$3.7)	\$0	(\$3.7)
GAPE	(\$0.5)	\$0	(\$0.5)
Total	\$26.7	\$12.4	\$39.1

Note: Numbers may not sum due to rounding.

Source: Aurizon Network, FY2017 Revenue Adjustment Amounts—Explanatory Memorandum, December 2017.

Stakeholder comments

Pacific National said it was concerned about the treatment of rebates, the transparency of take-or-pay capping and the reliability of forecasts.³

QCA assessment

The QCA has determined that Aurizon Network has appropriately calculated all of the proposed revenue adjustments. Table 2 shows the breakdown of Aurizon Network's claim against the criteria set out in the 2016 undertaking.

¹ Aurizon Network, *FY2017 Revenue Adjustment Amounts—Explanatory Memorandum*, September 2017.

² Aurizon Network, *FY2017 Revenue Adjustment Amounts—Explanatory Memorandum*, December 2017.

³ Pacific National Response to the Aurizon Network Submission 2016–17 Revenue Adjustment Amounts to QCA.

Table 2 Aurizon Network's revenue adjustment amounts (2016–17) against the 2016 access undertaking criteria

	<i>Clause in the 2016 access undertaking</i>	<i>Aurizon Network's adjustment (\$ million)</i>
Allowable revenue		\$1,093.23
Maintenance adjustments	cl. 4.3(c)(i)	-\$3.66
Opex adjustments	cl. 4.3(c)(ii)	-\$2.13
Connection charges adjustments	cl. 4.3(c)(iii)	-\$0.48
Audit costs	cl. 4.3(c)(iv)	\$0.04
Condition-based assessment	cl. 4.3(c)(v)	–
Ground penetrating radar system (GPRS)	cl. 4.3(c)(vi)	–
Rebate adjustments	cl. 4.3(c)(vii)	-\$2.15
UT4 compliance costs	cl. 4.3(c)(viii)	\$0.09
Other adjustments	cl. 4.3(c)(ix)	–
<i>Adjusted allowable revenue (AAR)</i>	cl. 4.3(c)	\$1,084.94
Less: Total actual revenues (TAR)		
AT2–4	cl. 4.3(d)(i)	\$829.39
AT5	cl. 4.3(g)	\$141.68
Cross-system, take or pay and relinquishment	cl. 4.3(d)(i)(B), cl. 4.3(g)(i)(B), cl. 4.3(d)(ii), cl. 4.3(e), cl. 4.3(f)	\$74.76
5% non-provision of service	cl. 4.3(d)(iii)	–
<i>Total actual revenues (TAR)</i>		\$1,045.83
Revenue adjustment amount (AAR minus TAR)	cl. 4.4	\$39.11

Note: Numbers may not sum due to rounding.

Sources: Aurizon Network, *FY2017 Revenue Adjustment Amounts—Explanatory Memorandum*, December 2017; Aurizon Network's 2016 access undertaking.

Operating and maintenance adjustments

The maintenance and operating expenditures are set in the original regulatory cycle but adjusted for differences between the forecast and actual maintenance cost index (MCI) and consumer price index (CPI).⁴ The QCA has

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

reconciled the indices and found that Aurizon Network had calculated these adjustments in accordance with the undertaking (Schedule F, cl. 4.3(c)(i),(ii)).

Connection charge

The 2016 undertaking entitles Aurizon Network to pass on the difference between actual connection charges incurred and the forecast used in setting the reference tariffs. The QCA has reviewed Aurizon Network's calculations and supporting invoices and is satisfied that Aurizon Network has correctly calculated the adjustment (Schedule F, cl. 4.3(c)(iii)).

Audit, condition and compliance

The undertaking includes provisions that allow Aurizon Network to claim for costs associated with audit, condition-based assessment, ground penetrating radar systems (GRPS), and compliance to the extent they are prudently and efficiently incurred (Schedule F, cl. 4.3(c)(iv)–(vi),(viii)).⁵ Aurizon Network did not claim for costs associated with the condition-based assessment or the GPRS.

Audit costs

The QCA is satisfied that the method used to calculate audits costs is appropriate and the costs were efficient (Schedule F, cl. 4.3(c)(iv)). The amount calculated for audit costs represents a \$42,200 recovery from access holders. Aurizon Network provided invoices that demonstrated the audit activities undertaken in the financial year, as well as the amounts incurred.

Compliance costs

Aurizon Network may pass through compliance costs to the extent they have been approved in writing by the QCA as efficiently incurred (Schedule F, cl. 4.3(c)(viii)). Aurizon Network claimed \$91,667 in compliance costs, but provided few details. It subsequently explained this was for developing a confidential information register (cl. 3.14) and creating a train service entitlement (TSE) reconciliation report (Schedule G, cl. 8.2). Aurizon Network provided invoices that substantiated these project costs. The QCA has confirmed the rates were consistent with market rates and is satisfied that the costs were incurred efficiently.

Total actual revenues and reference tariffs

The majority of the total actual revenue (TAR) is made up of system and cross-system AT2–AT5 tariffs (Schedule F, cl. 4.3(d)(i), (g)(i)(B)). The QCA has verified that Aurizon Network calculated its system and cross-system tariff revenues in accordance with the 2016 AU. Aurizon Network provided details of its calculations to demonstrate that the cross-system tariff rates were calculated based on Schedule F, clause 2.3; these reconciled with QCA calculations.

The volumes submitted by Aurizon Network and billing adjustments were also reconciled to publicly available information in Aurizon Network's quarterly performance reports.⁶

The QCA notes Pacific National's comment that revenue adjustment amounts could be minimised if Aurizon Network improved the volume forecasts through greater consultation with supply chain participants.⁷

Accrual for breach or negligence

The undertaking requires Aurizon Network to accrue additional revenue if five per cent or more of services for any origin-destination pair are not delivered due to negligence or a breach of an access agreement

⁵ These provisions were added in the 2016 access undertaking.

⁶ Performance Measure 8 (Coal Carrying Train Service Performance) in each of Aurizon Network's public quarterly performance reports for the 1st quarter 2016/17, 2nd quarter 2016/17, 3rd quarter 2016/17 and 4th quarter 2016/17.

⁷ Aurizon Network, FY2017 Revenue Adjustment Amounts—Explanatory Memorandum, September 2017.

(Schedule F, cl. 4.3(d)(iii), (g)(ii)). Aurizon Network confirmed in response to a request for further information that it had not received any claims for breaches or negligence relating to the 2016 access undertaking for 2016–17.

Take-or-pay

Aurizon Network provided detailed information on how it calculated the take-or-pay under its access contracts. The QCA was able to confirm that Aurizon had correctly calculated the take-or-pay that applied for agreements signed during each undertaking period (Schedule F, cl. 4.3(d)(ii)).

The deeming principle requires that the TAR should account for revenues Aurizon Network is deemed to be entitled to, based on the standard access agreement that was in force at the date an access agreement was executed (Schedule F, cl. 4.3(d)(i)). Therefore, the TAR includes an accrual for any entitlement under the approved standard access agreement, and does not reflect any variation from that standard.

Aurizon Network's initial submission did not provide sufficient information for the QCA to determine whether the deeming principle had been applied to transfers and renewals of contracts signed under the 2001 undertaking (UT1). Aurizon Network subsequently provided sufficient information for the QCA to establish that the accruals for 2001 contracts were correct (Schedule F, cl. 4.3(d)(ii)).

Pacific National raised the concern that Aurizon Network's submission was not sufficiently transparent about why a take-or-pay cap applied for Blackwater. The QCA confirms that Aurizon Network provided detailed models illustrating the triggering of the take-or-pay provisions, which enabled the QCA to verify that the take-or-pay on the Blackwater system capped.

Rebates

The revenue calculations include amounts paid as rebates to access holders who have provided Aurizon Network with funds to underwrite capital investments. The QCA could confirm Aurizon Network's rebate amounts by reviewing its calculations, requesting more information and reconciling rebate amounts to the QCA's own models. The rebates were therefore appropriately treated under the terms of the 2016 undertaking (Schedule F, cl. 4.3(c)(vii)).

Transfer and relinquishment fees

Aurizon Network is required to accrue relinquishment and transfer fees in its application (Schedule F, cl. 4.3(d)(ii), (e), (f)). Contracts were transferred in the financial year, but Aurizon Network said they did not result in any fees. Aurizon Network provided additional information in response to follow-up requests, which allowed the QCA to verify that zero was the appropriate accrual for 2016–17.

Overall, the QCA is satisfied that Aurizon Network has appropriately calculated the above revenue adjustment components as required under the relevant clauses in the undertaking.

Decision

The QCA is satisfied that the entire amount proposed in Aurizon Network's revenue adjustment submission, as amended on 5 December 2017, has been calculated in accordance with Schedule F, clause 4.3 of the 2016 access undertaking.

The QCA has therefore made a decision to approve the submission under Schedule F, clause 4.3(m) of the 2016 access undertaking