Submission to the QCA on the Aurizon Network DAAU relating to Electric Traction Pricing in the Blackwater System

June 2013

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1 BACKGROUND

Asciano welcomes the opportunity to make a further submission to the Queensland Competition Authority (QCA) in response to Aurizon Network's submission of a Draft Amending Access Undertaking (DAAU) relating to electric traction pricing in the Blackwater system. Asciano has previously made submissions on this issue to the QCA in April 2012, September 2012 and November 2012. To the extent that issues raised by these previous Asciano submissions have not been addressed in the Aurizon Network April 2013 DAAU; Asciano is seeking that these issues be considered by the QCA in this consultation process.

Asciano has a strong interest in electric traction pricing in the Blackwater system via its Pacific National Coal subsidiary. Pacific National Coal has access agreements in place to carry coal through the Blackwater system.

Asciano believes that this issue needs to be finally resolved in this current DAAU process.

Asciano has major concerns with the proposed April 2013 DAAU and is seeking that this DAAU be rejected by the QCA.

This submission is public.

2 OVERVIEW

The central Aurizon Network position on electric traction pricing in the Blackwater system has not changed since its initial December 2011 DAAU. This December 2011 DAAU sought to:

- socialise electricity across the Central Queensland Coal Network (CQCN);
- require diesel operators to pay for electricity infrastructure which they do not use; and
- reduces market choice in traction type for above rail solutions.

Under the current April 2013 DAAU Aurizon Network is proposing:

- socialisation of electric tariffs across the CQCN remains as an option;

- operators and users who do not use Blackwater electric infrastructure in the system may be required to pay for electric infrastructure which they have not used; and
- pricing which reduces market choice in traction type for above rail solutions.

Asciano's position is that there has been minimal shift in the intent of the Aurizon Network electric traction DAAU over the past 18 months. Under the current April 2013 DAAU the potential for diesel operators and users to pay for electric infrastructure which they do not use means that Aurizon Network charges to diesel users will not reflect actual costs incurred by these users, which would result in cross subsidies from these diesel users to users of electric traction.

The current April 2013 DAAU remains based on the unproven Aurizon Network assumption that electric traction is more efficient than diesel traction. In order to prove that electric traction is more efficient than diesel traction Aurizon Network needs to accurately model the preferences, capital constraints discount rates and costs of both traction options for all rail access seekers into the future, as well as modelling the impacts of technological change on both traction options[1]. Such modelling is not possible and thus the position that electric traction is more efficient than diesel traction is unproven and unprovable, thus the assumption underpinning the April 2013 DAAU that electric traction is more efficient than diesel traction is flawed.

Asciano maintains that if any train (regardless of traction type) is inefficient then this issue is best addressed through a capacity multiplier. The capacity multiplier seeks to take account of the fact that different trains have different operating performance which impacts on network capacity. The framework for such a multiplier exists in the current AT2 reference tariff structure.

In addition, the current April 2013 DAAU has not addressed the principle that traction choice should be an issue for operators, users and access holders and should be based on both cost and operational considerations relevant to the party or parties involved. Traction choice should not be driven by a party which has invested heavily

[1] For a more detailed discussion of this issue see the CEG Report QR Proposed Electrics Undertaking Pricing April 2012particulalrly pages 5-7 as attached to the Asciano April 2012 QR Network Draft amending access Undertaking – electric Traction Services Asciano Submission to the QCA

in a given traction choice subsequently utilising a regulatory process to drive other parties to effectively ensure that this investment is profitable.

In resolving the electric traction pricing issues, Asciano believes that any solution must meet the following criteria:

- it must allow for market based decisions on traction choice in above rail markets;
- it must ensure pricing methodologies and outcomes are efficient for electric and diesel traction operators and for users of both the Goonyella and Blackwater systems;
- it must be competitively neutral and non–discriminatory for above rail operators and traction types, that is it must not favour one rail operator or traction type over another, distort competition in the above rail market or have an anti-competitive impact in the above rail market; and
- it must ensure future pricing certainty via transparent pricing methodologies and regulatory certainty.

The current DAAU does not respond to these points and has the affect of moving operators and users towards electric traction solutions and requiring diesel operators and users to subsidise electric infrastructure. Thus Asciano believes that the current DAAU should not be approved by the QCA.

3 Outline of April 2013 Electric Traction DAAU

The April 2013 DAAU seeks to amend the current Access Undertaking by inserting a new schedule which ensures that the revenue required to recover the cost of Blackwater electric infrastructure is recovered from users of this electric infrastructure, and failing this from a broader pool of users including those who do not use this electric infrastructure.

In detail, if Aurizon Network cannot recover the costs of the Blackwater System electric infrastructure over the UT4 regulatory period, it will recover the shortfall from all access holders in the subsequent regulatory period. The Aurizon Network supporting submission indicates that there are three options being considered as to who will be required to pay the additional charge. Under all of these options diesel traction users in the Blackwater system will be required to pay an additional charge

for electric infrastructure that they have not used. In two of these options other users of the CQCN (e.g. Goonyella system users) will be required to pay an additional charge for electric infrastructure that they have not used.

The April DAAU 2013 also seeks to place into the undertaking a series of assumptions that should be used in determining the AT5 tariff.

4 Asciano's Major Concerns with the April 2013 Electric Traction DAAU

4.1 No Fundamental Change to the Aurizon Network Proposal

As noted above in section 2 the Aurizon Network proposal has not fundamentally changed in its affect since the December 2011 DAAU.

Aurizon Network's proposal has not fundamentally changed since the initial December 2011 DAAU as socialisation of electric tariffs across the CQCN remains as an option, operators and users who do not use Blackwater electric infrastructure in the system may be required to pay for electric infrastructure which they have not used and it continues to restrict traction options for above rail operations.

The April 2013 DAAU continues to be based on an unproven and unprovable Aurizon Network assumption that electric traction is more efficient than diesel traction, and as a consequence of this position traction choice should be influenced by the network owner rather than remain a commercial and operating decision for above rail operators and users.

In addition none of the three under utilisation payment (UUP) options outlined in the Aurizon Network submission results in a cost reflective AT5 tariff which is paid by users of the electric infrastructure. These options all rely on non-users of Blackwater electric infrastructure to fund the revenue shortfall for this infrastructure. Thus the tariffs are not cost reflective and cross subsides will continue to exist.

The UUP options all effectively require diesel users to fund electric infrastructure they do not use. By doing this Aurizon Network is trying to both underpin previous investments which are being under utilised and trying to move users towards electric above rail options (where this may act to benefit Aurizon Network's related operator).

A further concern with the UUP options is that they would result in substantial price fluctuations at the end of every regulatory period leading to price uncertainty for users.

4.2 Asset Optimisation

The Access Undertaking addresses circumstances where the QCA can reduce the value of assets in the Regulatory Asset Base. In relation to the Blackwater electric infrastructure assets the most relevant clause is Schedule A 1.4 b) and c)

> *The QCA will not require the value of assets contained in the Regulatory Asset Base to be reduced unless...*
> *b) circumstances arise in the future where demand has deteriorated to such an extent that regulated prices on an unoptimised asset would result in a further decline in demand;*
> *c) it becomes clear that there is a possibility of actual (not hypothetical) bypass*[2]

Asciano understands that the recent round of electric traction DAAUs is driven by Aurizon Network concerns related to recovery of the capital expenditure incurred for the Blackwater electric infrastructure upgrade, and the potential for this expenditure to be subject to the asset optimisation provisions of the Access Undertaking.

This Blackwater electric infrastructure capital expenditure has been subject to an external approval process (the Coal Rail Infrastructure Master Plan (CRIMP)). As Asciano understands it, the CRIMP process does not allow Aurizon Network to avoid any optimisation test, so while consideration of CRIMP issues may be relevant to some extent they are unlikely to change the outcome of any optimistation test.

In addition, Asciano understands that the CRIMP stated[3] that electrification was contingent on operators using electric traction. Thus it seems that under the CRIMP further electrification should not occur if operators had the option of using diesel traction. Given this, Asciano queries the ongoing Aurizon Network investment in electric infrastructure in the Blackwater system.

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[2] It should be noted that the Aurizon Network Supporting Submission p1 states that "users of the Blackwater system can bypass the electrification infrastructure by running non-electric traction modes" which appears to support a view that the electric infrastructure has been bypassed.

[3] QR Network Access Coal Rail Infrastructure Master Plan 2007 page 91

In this CRIMP process Aurizon Network did not seek an increased tariff to reflect an increased risk of asset optimisation (Asciano notes that the Access Undertaking Schedule J s 30 explicitly contemplates the potential for a higher WACC if asset stranding risk is incurred). Thus in relation to Blackwater electric infrastructure Aurizon Network either:

- considered the risk of asset optimisation and made a conscious decision that this risk was minimal or otherwise able to be managed; or
- did not consider the risk.

Asciano believes that Aurizon Network considered the risk and regarded the risk as able to be managed. This position is borne out in comments made by of Aurizon Network (then QR Network) in 2006[4]. In 2006 Aurizon Network expressed concerns with the viability of the level of Blackwater electric tariffs and saw two options; namely:

- managing the issue via "sculpting" the depreciation profile to smooth electric infrastructure pricing: or
- asset optimisation as per the process in the Access Undertaking.

Aurizon Network selected the former option, which has deferred the issue of cost recovery, and has then followed this with further electrification capital works and upgrades. Aurizon Network has been aware of the potential of asset optimisation risk for the Blackwater electric infrastructure since 2006 but has not sought to address this risk via higher returns for the asset in question.

In 2011, Aurizon Network again expressed concerns with the viability of the level of Blackwater electric tariffs and again has sought to defer the issue via the current April 2013 DAAU and further electrification capital expenditure (the electrification of the Rolleston line).

Asciano believes that the issue of asset optimisation for the Blackwater electric infrastructure asset needs to be confronted. The issue has been deferred in 2006 and the April 2013 DAAU seeks to defer the issue again. Asciano is concerned that

[4] QR Network 2006 submission in relation to UT2 as quoted in Queensland Resource Council Submission to the QCA Electric Traction Services DAAU September 2012 pp5-6

that the April 2013 DAAU is only concerned with recovering Aurizon investment with no regard as to whether this investment was efficient. If the investment cannot be recovered the efficiency of the initial investment should be queried.

Asset stranding should continue to remain a viable regulatory alternative for under utilised infrastructure or inefficient infrastructure investments. Asciano is concerned that there is a view that given the capital expenditure has been incurred the regulatory and pricing approaches should be manipulated to ensure the capital costs are recovered regardless of whether they were efficient. This removes any incentive for future prudent investment by Aurizon Network.

4.3 Assumptions and Positions in the Aurizon Network Supporting Submission

The Aurizon Network supporting submission contains numerous assumptions and positions which should be questioned.

4.3.1 Monopoly Position of Electric Infrastructure

The Aurizon Network supporting submission takes a position that the Blackwater electric infrastructure is a natural monopoly (as its marginal cost is below its average cost) but that the electric infrastructure is not fundamentally necessary to the operation of the rail network as operators and users can choose to use the electric infrastructure or not. (Asciano notes that prior to entering the Aurizon Network in 2007 it was informed that the Blackwater system could not accommodate AC electric locomotives due to power and signalling constraints. Consequently Asciano made a decision to invest in diesel locomotives for Blackwater operations. The choice of electric traction was removed due to system constraints).

To the extent that operator and user choice results in the natural monopoly not recovering its revenue Aurizon Network are seeking to compel those that choose to not use the asset to pay for the asset up to the level of the revenue cap regardless of whether they use the asset or not. To some extent this issue of a natural monopoly asset where users have discretion in using the monopoly asset due to the availability of alternatives is analogous to a suburban gas network. Residents can choose to use or not use the gas network depending on their own preferences for gas or electricity. Users of the gas network pay for the gas network but non-users do not. Asciano believes that to the extent that operators and users can choose other alternatives to the electric infrastructure the use of natural monopoly pricing models based on

revenue recovery need to be re-considered given the potential for volume impacts. Where users can choose to use natural monopoly infrastructure other approaches may be required.

The electric infrastructure has natural monopoly cost characteristics but the usage of the asset is discretionary. In these circumstances, rather than avoid volume risk by using a revenue cap (which results in a price increase if volumes fall) it may be preferable to use a price cap and take the volume risk.

4.3.2 EGTK Clarifications

The April 2013 DAAU is based on a position that in order for the Blackwater electric infrastructure to be financially sustainable when forecast volumes are achieved, a level of 85 per cent of the system capacity egtk is required to be met. Where egtk usage is less than 85 per cent there will be a revenue shortfall that will be met by an under utilisation payment (which will be paid by all users including diesel traction users).

Asciano has several concerns with this position:

- the terminology "when forecast volumes are achieved" implies that volumes are forecast to increase but in its recent 4 April 2013 submission to extend UT3 Aurizon Network was forecasting a reduction in volumes in the Blackwater system in 2013-14[5] (this submission was later withdrawn by Aurizon Network). The Aurizon network view on volume forecasts should be clarified; and
- the system capacity is not defined. It is not clear whether the Aurizon Network position is based on 85 per cent of forecast volumes or 85 per cent of theoretical Blackwater system capacity. This should be clarified.

5 CONCLUSION

The central Aurizon Network position on electric traction pricing in the Blackwater system has not changed since its initial December 2011 DAAU. Under the current DAAU the potential for diesel operators and users to pay for electric infrastructure they do not use means that Aurizon Network charges to diesel users will not reflect

[5] See 4 April 2013 Letter Mike Carter (Aurizon Network) to Dr Malcolm Roberts (QCA) Draft Amending Access Undertaking to Extend the term of the 2010 Access Undertaking page 4

the costs incurred by these users resulting in cross subsidies from these users to users of electric traction. Traction choice should remain an issue for operators, users and access holders and should be based on both cost and operational considerations relevant to the party involved.

Asciano believes that the issue of asset optimisation for the Blackwater electric infrastructure asset needs to be confronted. Asciano is concerned that there has been no focus on the issue of whether this investment was efficient. Asset optimisation should continue to remain a viable regulatory alternative for under utilised infrastructure or inefficient infrastructure investments.

Asciano believes that the current DAAU should not be approved by the QCA.