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Queensland Rail's draft 2013 Undertaking – reference tariffs

Thank-you for the opportunity to provide this submission on Queensland Rail's proposed Reference Tariff Reset.

QRC has had concerns regarding the derivation of West Moreton reference tariffs for some time. Tariffs determined under previous undertakings in regard to the West Moreton system were not based on a robust, repeatable methodology. For example, a regulatory asset base ("RAB") has not previously been established.

QR now proposes to establish a repeatable methodology based on a 'building block' approach, and this is generally supported. However, establishing such a methodology for the first time, and in particular establishing a RAB for the first time, must involve more than simply adding together a number of components which have been developed on a stand-alone basis. QR has proposed such an approach. QRC considers that this approach is fundamentally flawed and leads to a proposed tariff which will not promote economically efficient use of the infrastructure. Rather, the proposed tariffs would be likely to lead to reduced utilisation of the infrastructure, which would then lead to:

- A reduction in revenue for QR, in economic activity and in employment, and in royalties for the State; and
- Potential claims from QR for further tariff increases due to reduced volumes, which, if approved, may then accelerate the decline in volumes.

On this basis, we consider that approval of the proposed tariffs would not be in the public interest, nor in the interests of access seekers, and ultimately may not be in QR's interests.

Our view that the simple addition of the building block elements results in an inappropriate tariff is based on the following observations:

- **The tariff outcome represents extremely poor value compared to that offered in other coal systems and will place West Moreton mines at a serious competitive disadvantage:**

  The proposed tariff is at least double (and is generally substantially greater than double) the below rail

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charge for other coal systems in Queensland and New South Wales, yet, due to the characteristics of the network, delivers a service which is of significantly lower standard. These below rail characteristics have been well documented in previous submissions. The below rail conditions result in substantial additional above-rail costs.

- **The tariff outcome risks causing reduced utilisation of the West Moreton system.**

  QRC has had discussions with all current coal producers on the West Moreton system. The consistent message of coal producers is that existing rail costs in the West Moreton system are not only a significant disincentive to growth and investment, but also create a competitive disadvantage which is not sustainable in the current market. The proposal to further increase tariffs will clearly exacerbate this problem. We understand that confidential data will be provided by a number of coal producers to demonstrate these issues.

QRC suggests that the fundamental problem with QR's proposed methodology is that the proposed RAB is overvalued and is not consistent with other building block elements. In particular:

- The proposed RAB is excessive given the level of proposed maintenance and ongoing capex (which does not provide additional capacity). We suggest that, if QR's maintenance and capex forecasts are found to be prudent, this indicates a poor asset condition which has not been adequately reflected in the DORC valuation (specifically, in the 'optimisation' step). The evidence of this is in the uncompetitive and unsustainable tariff outcome. Just as a mine which has very high operating costs would have a low market value, the true value of QR's asset is lower due to its high ongoing costs.

- The proposed RAB is also overvalued given the service which can be provided by these assets. Again, the evidence of this is in the uncompetitive and unsustainable nature of the proposed tariff.

Conclusion:

QRC considers that the proposed tariffs should not be approved, having regard to the criteria set out in Section 138 of the QCA Act. The proposed tariffs would not promote economically efficient use of the infrastructure, because utilisation of the infrastructure would be likely to decline. Tariffs at the levels proposed are also likely to negatively impact on competition in coal markets, by reducing volumes mined in this region. The proposed tariffs are not in the public interest, as economic activity, employment, taxes and royalties are likely to be reduced. Finally, the proposed tariffs are clearly not in the interests of persons who may seek access to the service.

Proposed solution:

QRC suggests the following approach to development of efficient tariffs for the West Moreton system:

1. Conduct a thorough review of all operating costs, maintenance costs and capex and reduce each element to an efficient cost, based on the scope of work which is necessary over the period of the undertaking.

2. Reduce the 'pre-1995' asset value, with the reduction being at least sufficient to ensure that the below-rail tariff is competitive with the next most expensive system in NSW or Queensland. We note that the pre-1995 value is not based on actual costs incurred by QR (or by any other party) through investment in this system, nor does it reflect book values. Rather, it is a theoretical estimation of a notional replacement cost, which is then optimised to reflect the actual asset condition. In our view, the previous DORC assessment focussed on the replacement cost element, and insufficient consideration was given to the optimisation process. The adjustment suggested above is the minimum optimisation adjustment required. Such an adjustment would fall well short of fully reflecting the difference between this asset and the modern engineering equivalent,

because a full adjustment for this difference would also take into account the impacts of the existing asset on above rail costs.

3. Optimise the pre-1995 RAB to fully reflect the difference between QR's asset and the modern engineering equivalent, taking into account the quality of the service which the asset is capable of delivering and the impacts of this on above rail costs.

4. If item 3 is not supported by the Authority, then to the extent that the resulting tariff (after the RAB is adjusted under item 2) is still likely to result in inefficient use of the infrastructure (due to the uncompetitiveness of the combined above/below rail cost), defer revenue for potential recovery at a time of improved market conditions (that is, a time when the un-competitiveness of the combined tariff is unlikely to result in inefficient use of the infrastructure). This could be achieved through:

    a. Deferral of depreciation.
    b. 'Loss capitalisation' (setting tariffs to recover less than the full revenue requirement, and adding revenue foregone to the RAB). This approach is used by ARTC in the Gunnedah region of NSW to ensure that below rail tariffs are efficient and do not disincentive use of the infrastructure. (Note: despite ARTC's Gunnedah system accommodating trains of 6500t payload, compared to 1940t in the West Moreton system, ARTC has found it necessary to reduce access charges to around half of the level proposed by QR in order to promote use of its infrastructure).

QRC and its Western System members will seek further engagement with QR in order to seek to resolve these issues and present an agreed solution to the QCA for its consideration. However, there is a vast gap between QR's current expectations and the tariff which QRC and its members consider would be reasonable and which would meet the criteria of the QCA Act. Given the distance between the parties, a timely draft decision on pricing matters would be welcomed.

Thank-you for your consideration of our submission.

Yours sincerely

[redacted]

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