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27 November 2012

**By email**

Mr John Hall  
Chief Executive Officer  
Queensland Competition Authority  
GPO Box 2257  
Brisbane, QLD 4001

Email: [rail@qca.org.au](mailto:rail@qca.org.au)

Dear Mr Hall,

**QCA request for further comments on a draft decision regarding QR Network's electric traction draft amending access undertaking (DAAU)**

Rio Tinto Coal Australia (**RTCA**) refers to the above process and provides the following response. RTCA confirms that this submission may be made public.

RTCA supports the draft decision of the Authority to reject the DAAU.

In doing so, however, RTCA notes the procedural concerns set out below, as to the inadequacy of the timeframe allowed for responses given the substantial volume of materials and complexity of the issues raised by the Authority. RTCA reserves its rights in that regard.

**QRNN's approach to electric traction is symptomatic of a UT3 regime that is not working**

As the Authority is aware, the debate around electric traction has continued for some time. While initially raised by QRNN as part of the UT3 process, the current draft DAAU was lodged in December 2011 and the Authority's recent request for comments is the third such request.

By their nature, DAAUs (especially those that involve reopening the structure of reference tariffs) should be an exceptional event – given the importance of ensuring regulatory and price certainty for all stakeholders during the regulatory period.

In this case, the draft DAAU was submitted by QRNN in December 2011 following little or no consultation with coal producers, and without the support of industry. The original QRNN submission referred to modelling, assumptions and data which were not provided (including their own 'total cost of ownership' (TCO) analysis) and which was therefore unable to be analysed or tested by stakeholders.

Despite this, RTCA and other coal producers tried to engage constructively with QRNN over subsequent months through the Traction Working Group to understand its concerns in relation to electric traction and the operation of AT<sub>5</sub>. RTCA has also invested significant time and resources to setting out its views in three submissions to the Authority.

RTCA submits that the Authority's response period (of approximately 6 weeks) does not allow stakeholders a reasonable and fair opportunity to respond to the issues it has raised and the submissions, given the following:

- QRNN and QR National's most recent submissions to the Authority in response to the draft decision are substantial and include a number of new and modified arguments as well as substantial additional economic and technical analysis. QRNN have approached a number of locomotive manufacturers, electricity industry stakeholders and others to submit material in support of their position. Taken together, there are over 1,000 pages of additional submissions and material. QRNN's latest submission alone is more than seven times longer than its original supporting submission when the draft DAAU was lodged.
- QRNN has significantly shifted in its position on a number of important issues.
- Meaningful access to the QRNN TCO model has not been achieved. Access to it has only been made available on an extremely limited basis – in person and 'on site' at QRNN and subject to individuals accepting unreasonable confidentiality constraints. This makes it impossible for industry stakeholders (and, we submit, the Authority) to form a view about the appropriateness of any efficiency analysis claimed by QRNN in relation to electric traction based on TCO analysis. In the absence of full disclosure, little (if any) weight should be given by the Authority to QRNN's TCO and related efficiency claims.
- The Authority has sought input on a set of complex economic, legal and technical questions, a number of which may have ramifications for the way that future DAAU processes occur.

Allowing only six weeks for responses, particularly in light of the number of other substantial regulatory processes which are currently underway, does not permit RTCA and other stakeholders a sufficient opportunity to respond on what are extremely important (and potentially costly) proposals.

### **A proposed way forward**

In the circumstances, RTCA submits that the Authority should adopt an alternative approach to the electric traction issue, which provides for greater transparency, 'ownership' by all stakeholders and one that is not dictated by the timing and commercial objectives of QRNN and its current draft DAAU. This could also provide a better precedent for how complex issues like this are handled in the future.

RTCA proposes that the existing DAAU is either rejected by the Authority or withdrawn by QRNN – so that engagement is not hamstrung by arguments about the terms of the existing draft DAAU which detract from constructive discussions.

If QRNN refuses to withdraw the DAAU, RTCA submits that the Authority is empowered under s.142 to reject the undertaking without proposing an alternative, on the basis that substantial further engagement is required before it would be in a position to identify any alternative and/or that the Authority considers that the issue is better dealt with through the UT4 process, which would then permit a range of related issues to be addressed in an integrated manner.

Finally, the root cause of the traction issue is the dysfunctional CRIMP process where QRNN provided insufficient information to coal producers to enable them to make an

informed decision on electrification investments while in other respects (such as the Powerlink transaction), the process was not used at all. Fundamental reform to the CRIMP process is needed if disputes of this kind are to be avoided and, as such, reform of the CRIMP process must occur as part of the **same process** as any DAAU associated with electrification.

### **The CRIMP process must be urgently fixed as part of any ‘negotiated outcome with industry**

The Authority, in its questions, acknowledges that the root cause of the electric traction issue is the longstanding failure by QRNN to properly and transparently engage with coal producers around network planning and investments, through the CRIMP process.

The CRIMP process:

- Occurs irregularly and only when it is in QRNN’s interest to do so (usually where it needs a customer vote to protect projects from the risk of optimisation).
- Does not permit meaningful engagement by coal producers in planning decisions, including because it offers coal producers little more than “planning by powerpoint” with little, if any, detailed technical information or engagement.
- Does not provide any transparency over how projects approved through the CRIMP are being delivered and any confidence for coal producers that the projects they are funding are being delivered on time and on budget.
- Is characterised by QRNN doing little more than seeking to rush through approval (or deemed approval) by coal producers, whilst minimising consultation.

Despite these very significant failings, and perhaps *because* of them, QRNN has sought to use the CRIMP process on a number of occasions to justify substantial unexplained expenditure – in the present case, almost \$400 million on electrification of Blackwater and related power contracts. Earlier this year, QRNN discontinued a ‘Request for Proposals’ process in relation to the Goonyella system – after several months of putting coal producers to considerable effort and expense – because it identified that the feasibility and design work which it was looking for customers to fund had largely been completed and funded through \$50 million “approved” funds through a CRIMP several years earlier.

When compared with other rail master planning & investment approval processes (e.g. the Rail Capacity Group provisions under the ARTC Hunter Valley Access Undertaking) and the regulatory engagement and transparency provided in other industries, such as gas and electricity, the CRIMP process stands out as arguably the worst regulated planning process in the country.

RTCA has previously identified to the Authority that below rail costs are the largest infrastructure cost element it faces in its Queensland coal business. Given the extreme cost pressure faced by the Queensland industry, it is critically important to coal producers that CRIMP is fixed as part of any resolution of the electric traction issue.

The CRIMP issue cannot be left to be resolved separately (until UT4) for two reasons:

- Given current expectations, there seems little likelihood that UT4 will be approved before the middle of 2014, at the earliest. Getting the planning process fixed cannot wait almost two years.

- The CRIMP failings have been acknowledged by QRNN and industry as the central regulatory cause of the ‘electric traction’ dispute. For the Authority to seek to resolve a tariff issue, without dealing with the root planning problem, would be to respond to the symptom without resolving the longstanding and serious regulatory failure which had caused the problem.

For these reasons, any “negotiated” outcome which the Authority attempts to facilitate in relation to electric traction **must** include a fundamental reform of the CRIMP process. In order to facilitate the development of a transparent and integrated master planning process, RTCA attaches with this submission a regulatory roadmap setting out the overall planning, investment and operational features which it considers urgently need to be put in place under UT3 and/or UT4. While some individual elements already exist in the existing Access Undertaking, many are not working as intended (e.g. CRIMP), do not operate in an integrated manner, and lack clarity (and therefore enforceability by the Authority and coal producers).

**The role of TCO analysis, if any, should be as part of planning processes for future investment, not to justify past investment decisions**

As noted above, it is critical for investment certainty that regulatory pricing structures and tariffs are not able to be reopened by QRNN, except in extraordinary circumstances.

It appears in this case that QRNN has developed a TCO model, together with over a thousand pages of additional submissions and material, to seek to support its investment only **after** the investment has occurred. This contrasts with the large amount of information provided by QRNN to coal producers before it makes investment planning decisions, including in relation to electrification of Blackwater.

RTCA submits that:

- The TCO analysis proposed by QRNN has limited, if any, relevance to an assessment of the efficiency or appropriateness of past (sunk) investment.
- If it plays any role, TCO modelling should form part of the master planning arrangements undertaken prior to investment decisions – including as a means for QRNN, coal producers and other stakeholders to collectively test the appropriateness of proposed capital expenditure.

QRNN should not be permitted to rely upon any modelling that has not been made fully available to industry. This is especially so in the case of TCO modelling, which involves complex assumptions about a range of matters in the coal supply chain which are not known to QRNN.

More generally, RTCA considers that a new approach is needed in which claims made by QRNN for confidentiality are rigorously tested with stakeholders before being accepted by the Authority. We expect that in most cases there will be a strong public interest in modelling, assumptions and other material being made available to all stakeholders under s.239, particularly where QRNN is seeking to rely upon that modelling or material in processes that impose costs on coal producers.

Preferably, a fully independent model needs to be commissioned with the input and ‘ownership’ of all stakeholders, including coal producers, terminal operators, rail operators and QRNN – and which can then be used by all stakeholders as an input into their regular collective assessment of projects in an overhauled CRIMP process.

## **RTCA's proposed regulatory roadmap (alternative Capital Planning and Investment Framework)**

RTCA will provide detailed input to the Authority, industry and QRNN around the various elements of the attached roadmap as part of any industry engagement process led by the Authority in relation to 'electric traction' as well as future processes (notably, UT4).

### **Responses to other issues identified in the Authority's discussion paper**

The following is a table outlining RTCA's intended position on the issues raised in the QCA paper.

- |  |  |
|--|--|
| <b>1. Traction choice</b>  | RTCA will reiterate its earlier submission that traction choice is an issue that should be left to the market, based on a price that reflects costs.   |
| <b>2. Efficiency of electric over diesel</b>   | <p>RTCA will reiterate its view that electric is not more efficient in the Blackwater System. In doing so, RTCA will note that it has not seen QRNN's TCO modelling and without that modelling being made publicly available, the Authority should not grant it meaningful weight.</p> <p>Coal producers ultimately take their own views of TCO for their operations and this is reflected in their traction choice – it should not be dictated by QRNN or the regulator.</p>  |
| <b>3. TCO and the object of Part V</b>   | RTCA agrees with the approach proposed by the Authority.   |
| <b>4. Competition in the locomotive market and geographic boundaries of Blackwater and Goonyella</b> | RTCA will say that the Authority does not need to reach a concluded view on either of these issues to deal with the electric traction issue.   |
| <b>5. Strategic conduct</b>  | <p>QRNN has provided no concrete evidence to establish that there has been strategic conduct on the part of rival train operators to QR National. The evidence referred to is highly speculative and theoretical.</p> <p>This argument also overlooks the fact that it is QR National's <i>customers</i>, not its <i>competitors</i>, which have been the most outspoken critics of the proposed DAAU.</p> <p>The argument suggests that QR National's competitors (running diesel locomotives) should instead be required to cross-subsidise the costs of their competitor.</p> |
| <b>6. Asset stranding</b>  | RTCA does not accept that the regulatory regime should not allow for stranding of assets. This is a commercial risk which QRNN takes when it invests substantially in capital expenditure which it has not had approved by its   |

customers – coal producers.

The available evidence shows that QRNN formed a commercial judgement that the take up of electric traction would justify the capital investment. If that decision was wrong, and QRNN now bears the cost of its commercial misjudgement, it should not be viewed as a failure of the regulatory regime or any kind of ‘asset stranding’. RTCA has highlighted in its initial submission that QRN was acutely aware of the key elements of its commercial decision whether or not to invest in further electric infrastructure as highlighted by its statement in section 7.3.3 of the 2007 CRIMP document (a section titled “Commercial Dilemma”):

*“7.3.3 Commercial Dilemma*

*The electrification decision is contingent upon the resolution of the following commercial dilemmas:*

*1. QR Network Access **should not further electrify the network if it cannot be sure that the operator(s) will use electric traction thereon***

*2. The operators should not only buy electric if they cannot be sure that the coal network will be fully electrified*

*..”*

The only protection which should be available to QRNN from the risk of asset stranding is where capex proposals have first been discussed with and then approved by customers following detailed, thorough, regular and complete disclosure.

**7. CRIMP**

Discussed above.

**8. Solutions**

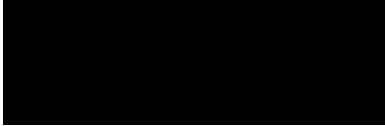
It is too early for RTCA to express a concluded view on any “solution”, except that if one is ultimately found to be required, it must:

- include a new CRIMP process acceptable to industry; and
- ensure that any modified reference tariffs apply to new or expanded capacity and not existing users of the Blackwater system (i.e. existing contracts and capacity are ‘grandfathered’).

RTCA looks forward to working with the Authority on exploring a more transparent, independent and inclusive approach to resolving issues of this kind.

Please refer any questions in relation to this letter to Xiao Fan Zhuang on 3625 5197 or myself on 3625 5533.

Yours sincerely,



**Tim Renwick**  
General Manager - Infrastructure



# A Capital Planning and Investment Framework for the Queensland Coal Rail Network

