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AUSTRALIA

Mr Charles Millstead
Chief Executive Officer
Queensland Competition Authority
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Electric Traction DAAU Draft Decision

Dear Mr Millstead

Thank you for the opportunity to provide comments on the Queensland Competition Authority's (QCA's) Draft Decision regarding Aurizon Network's 2017 Electric Traction DAAU.

This submission is provided by Rio Tinto and by Kestrel Coal Resources Pty Ltd ("KCR").

Rio Tinto has had long-standing concerns regarding Aurizon Network's various proposals to socialise the costs of electric traction across electric and diesel services. Rio Tinto has recently entered into agreements which are expected to result in an exit from the Queensland coal industry. We provide this submission because we wish to see our former mines and suppliers prosper and compete on fair terms.

KCR is a newly formed company owned by EMR Capital and Adaro Energy. KCR has entered into an Asset Sale Agreement, under which it will purchase Rio Tinto's 80% interest in the Kestrel mine. Completion of the purchase is expected in August or September of this year.

Rail services from the Kestrel mine currently employ diesel locomotives. Naturally, KCR's due diligence and valuation of the asset in regard to access charges focussed on the access charges payable by diesel trains. Aurizon Network's proposal, which could result in some of the costs of electric traction being paid by diesel services, is surprising and in our view inappropriate. KCR has reviewed the previous submissions made by Rio Tinto and Pacific National in regard to this issue, and supports those submissions.

Key considerations are:

- User pays principles should be applied, such that the cost of electric traction is paid by customers who are running electric trains.
- KCR has commitments to use diesel trains, and Pacific National has made long term investments in diesel locomotives. These investment decisions were based on regulatory arrangements in which diesel services were not required to pay for services which they cannot use. It is not appropriate to change the rules and shift costs to diesel services after long term commitments have been entered into.
- Separation of the costs of electric traction from other elements of access has been a feature of all access undertakings since regulation began. Overturning that principle introduces regulatory uncertainty, which discourages long term investment decisions.

We note that the QCA's Draft Decision is to reject the DAAU. This is appropriate. However, we also note that the QCA states that the proposal "has merits" and may consider approving an amended version which continues to violate user pays principles. KCR and Rio Tinto would not support such an approach unless a mechanism is introduced which protects sunk investments from the impacts of this substantial change.

We note the QCA's suggestion that thresholds (which trigger the socialisation of costs to diesel trains) should be lower. While this is a positive change, it should not be confused with effective 'grandfathering' is existing

diesel services. In a scenario in which the mechanism is triggered, the AT5 under-recovery will be socialised across all services.

True grandfathering would, for example, identify the existing diesel fleet, and exempt that rollingstock from socialised electric traction costs for a defined period. This would ensure that sunk investments are protected from the impacts of this substantial regulatory change. Threshold levels could then be set at close to 100% and would relate to train services other than those run using the 'grandfathered' diesel locomotives. Under this approach, socialised electric traction costs would only apply to diesel services:

- when an existing service switches from electric to diesel. This is appropriate and is entirely consistent with the fundamental purpose of the DAAU.
- When a new diesel service enters the system. Whether this is appropriate is a matter which we would ask the QCA to consider. To the extent that a new diesel service triggers investment in electric infrastructure (for example, a passing loop is added and must be electrified), then this outcome seems appropriate. In other cases, this socialisation is arguably not appropriate, although is more appropriate than levying a charge on existing diesel services, as the owners of new diesel services will at least be aware of this risk when investing. Reducing the threshold below 100% (still applied to all services other than the grandfathered services) would provide a partial solution, as it would ensure that the addition of a reasonable number of new diesel services would not trigger the mechanism.

We are also concerned about the impacts of the proposal on above-rail competition. Traction choice is a key feature of existing above-rail competition. [REDACTED]

Summary:

KCR and Rio Tinto have fundamental concerns with the DAAU proposal and with the QCA's possible support of a revised mechanism. We consider that effective grandfathering of the existing diesel fleet for a defined period is an essential requirement of any reasonable mechanism. This will go some way to addressing the issues of regulatory uncertainty, and the inappropriate impacts which the DAAU would otherwise have on existing access holders who have sunk investments.

Thank you for considering our submission.

Yours sincerely,

[REDACTED]

Ian Gibbons
Manager - Coal Chain, Infrastructure & Contractor Management
Coal Australia
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for [REDACTED] 29/06/2018
Peter Smith
Chief Executive Officer
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