

QRN Reference: DN/12/184613
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16 April 2012

Mr. E.J. Hall
Chief Executive
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Dear Mr Hall

QR Network's Electric Access Draft Amending Access Undertaking (DAAU)

Thank you for the opportunity to provide feedback on QR Network's proposed Electric Access amendments to the 2010 Access Undertaking.

QR National operates in a highly competitive above rail market, with a commercial imperative to deliver efficient, least cost services to our customers. With this in mind, QR National would like to comment firstly in a general sense, then to provide feedback in relation to the specific elements of QR Network's proposed amendments.

GENERAL COMMENTS

In general, QR National supports the proposed DAAU on the basis that it will promote the most efficient rail system solution.

In particular, we would like to comment on:

- total cost of ownership (TCO) as the appropriate measure for assessing supply chain efficiency;
- investments in electric assets based on user endorsement and regulatory pre-approval;
- the need for utilisation support and potential risks to long term efficiency; and
- QR National's openness to alternative regulatory options for the Goonyella and Blackwater systems provided that they maximise electric traction utilisation as the least cost supply chain solution.



Total cost of ownership in assessing supply chain efficiency:

QR National acknowledges that users ultimately bear both above and below rail costs. Consequently, while the regulatory framework applies specifically to below rail, the impacts of these arrangements on above rail operators will directly affect the overall cost to users.

As an above rail operator with extensive experience in fleet operation in both electric and diesel traction, QR National agrees that electric traction is the most efficient and lowest cost service, provided there is sufficient utilisation of the below rail electric traction asset base.

This has been demonstrated in Goonyella where electric traction represents a lower cost, higher capacity solution than diesel traction. Reasons include faster cycle times, more efficient train configuration and a lower incidence of interaction effects between diesel and electric consists. Based on this experience, QR National agrees that a TCO (above and below rail) approach to assessing the most efficient traction type is the appropriate method for determining how to achieve the lowest overall rail system costs.

Investment decisions, user endorsement and regulatory pre-approval:

QR National operates in a highly competitive above rail market, which provides us with opportunities to actively compete based on offering value to customers. In support of QR National's view that electric traction is the most efficient, we have made significant investments in electric traction locomotives, which are deployed in both the Goonyella and Blackwater systems.

QR National's investment decisions have been underpinned by the regulatory process, which has seen customers publically endorse investment in below rail electric infrastructure. QR National has supported customer endorsement with matching above rail investment in electric locomotives. To do otherwise would have been to waste the below rail investment, which customers have effectively agreed to pay for through the regulatory pre-approval process overseen by the Queensland Competition Authority (QCA).

Where the regulator has accepted users' endorsement of investment in electric infrastructure, service providers are entitled to rely on this information in making investment decisions. In an unregulated market, users would be required to sign binding commercial contracts prior to large capital investments being undertaken.

Where service providers cannot rely on the regulator to ensure reliable and consistent signals are provided about future investments and utilisation intentions, the incentive to invest in either above or below rail would be diminished.

Need for electric utilisation support and risks to long term efficiency:

Lower than optimal electric utilisation rates in Blackwater, exacerbated by recent limits to electric capacity prior to the completion of new feeder stations, has put upward pressure on the AT5 tariff component.

The relatively high AT5 charge results in electric traction access charges being higher than those for diesel traction, despite the application of a capacity multiplier to diesel services.

QR National considers that the Blackwater system is currently in a transition stage where large



amounts of capital investment in electric infrastructure are being prudently incurred before the resultant increase of electric utilisation rates. During the periods of capacity expansion, the lagged effect of electric utilisation will result in temporary increases in the electric tariff. While this is true of any capacity expansion, in the case of electric traction infrastructure, a competitive above rail market allows the electric traction assets to be bypassed.

In Goonyella, the electric traction utilisation rate is high at 100% and electric traction is competitively priced against diesel. While Goonyella users are currently benefiting from high electric traction utilisation rates, during earlier periods Goonyella would have also progressed through a transition phase as electric utilisation rates increased to match electric capacity.

As third party access arrangements apply to the below rail infrastructure, the vertical separation results in below rail and above rail costs being recovered separately. Therefore, trade-offs between above and below rail costs and benefits may or may not occur. This misalignment between the costs and benefits can result in a price that does not reflect the long run costs of the most efficient, least cost solution.

In Blackwater currently, a short term commercial benefit exists for diesel traction over electric traction, reflecting the differential between the AT5 tariff for electric below rail infrastructure and the much lower effect of the capacity multiplier applied to diesel traction.

QR National is concerned that operators and users are placed in a position of uncertainty, forcing them to choose diesel traction to mitigate the risk that future users will do the same, and thus leave them liable for payment of escalating AT5 access charges. In effect, this is unclear regulatory pricing signals leading to inefficient system traction choices.

QR National considers regulated access pricing arrangements are the best mechanism for appropriate price signals, which will promote electric utilisation and result in an efficient, least cost outcome.

Pricing Diesel traction on Electric systems:

QR National supports QR Network's proposals because we consider, if implemented, they would promote optimal electric traction utilisation in both Goonyella and Blackwater systems.

QR National agrees with QR Network that pricing of diesel traction should be cost reflective and that the full costs imposed on the rail system by a diesel service should be paid by diesel users. Consequently, we consider a review to determine a more cost reflective capacity multiplier to apply to non-reference trains is a priority.

We have provided more specific comments on QR Network's proposal below.

QR NETWORK'S PROPOSAL

QR Network is seeking approval from the QCA to:

1. introduce a single 'whole of network' AT5 charge;
2. introduce an 'electric utilisation rebate' whereby AT5 would be payable for at least ninety percent of train services that could operate as electric services, regardless of whether electric or diesel services are actually operated;



3. limit the annual increase in AT5 as a result of revenue cap adjustments to five percent with any additional under recovered amounts carried forward to be recovered in future years; and
4. include the costs of electrifying mainline enhancements that are required as a result of new non-electrified connections, into the incremental costs to be recovered from the diesel services using those non-electrified connections.

In support of its proposal to the QCA, QR Network has:

- provided evidence that electric traction is the most efficient traction type; and
- demonstrated how the proposals meet the requirements of the *Queensland Competition Authority Act 1997* (QCA Act), which underpins QCA decision making.

QR National's experience supports the superior efficiency of electric traction in that it delivers faster cycle times, requires less maintenance and has a lower fuel burden. Consequently we will not comment further on the merits of the TCO analysis. We agree that maximising electric traction utilisation in Blackwater and Goonyella will result in the most efficient, least cost rail system.

QR National notes that the objectives of the QCA Act include that the third party access framework should promote efficient use of, and investment in, the rail infrastructure. In addition, the pricing principles in the QCA Act provide for prices to recover efficient costs and provide incentives to reduce costs and improve productivity. Given the Electric Access DAAU aims to promote electric traction utilisation as the most efficient rail system solution, QR National considers that the proposed amendments support the objectives of the QCA Act in these respects.

QR Network's proposed DAAU seeks to address these issues.

1. Single 'whole of network' AT5 charge

QR Network proposes a single AT5 charge for Blackwater and Goonyella. QR Network argues that spreading the costs of the electric infrastructure across Goonyella and Blackwater users better reflects the network costs and benefits. As a result, utilisation rates will increase and the lowest overall electric traction costs can be achieved. In particular, the proposal recognises the benefits to Goonyella users of the investment in electric assets in the Blackwater system.

These benefits to Goonyella users include:

- a lower AT5 charge in Goonyella largely as a result of operators being able to operate at an electric utilisation rate of 100%; and
- that Goonyella users avoid the congestion effects of multiple traction types with different performance characteristics.

These benefits are derived from the ability of rail operators to effectively treat the systems as one, in that above rail fleet can be deployed flexibly to the system that achieves the most efficient (commercially beneficial) above rail outcome.

Consequently, QR Network has argued that Goonyella users should bear some of the costs of the benefits they enjoy as a result of Blackwater electrification.



QR National has customers in both Goonyella and Blackwater and understands the difficulties of introducing this change.

On this basis, we are actively supportive of continuing discussions aimed at finding a pricing mechanism that is appropriate to the objective and acceptable to users of both systems.

2. Electric utilisation rebate (Take or Pay on AT5)

QR Network proposes to introduce a requirement that the AT5 tariff component be paid for at least 90% of train services (across both Blackwater and Goonyella) which can feasibly be operated as electric train services (Assessable Traction Services). This will apply to actual train services operated regardless of whether these services are diesel or electric.

This acts as a take or pay on AT5 that only applies to train services actually operated, where those services could be operated with electric traction. The volume risk associated with raiiling lower than contracted volumes is excluded. QR Network would charge an AT5 tariff for all Assessable Traction Services and pay back a quarterly rebate for actual services that were operated as diesel, up to 10%.

The proposed arrangement provides a strong incentive for maximising electric traction up to 90% of the Assessable Traction Services. QR National considers that this will deliver benefits across both Goonyella and Blackwater in lower overall electric traction costs.

QR National agrees with QR Network that the Blackwater system is currently in a transition stage where large amounts of capital investment in electric infrastructure are being prudently incurred before the resultant increase of electric utilisation rates. We consider utilisation support, such as QR Network's proposed utilisation rebate, is justified where it results in a sustainable AT5 charge that is low enough to further encourage electric traction and promote the most efficient system outcome.

We note that QR Network has previously proposed an alternative form of access arrangement that would allow Coal Producers to contract directly with QR Network for below rail access rights. In these circumstances, the Access Holder would not necessarily control the traction choice of the operator. If the alternative form of access is put in place, consideration should be given to how the choice of traction would be dealt with under these access arrangements.

QR National supports the concept of the proposed electric utilisation rebate, on the basis that it would allow operators to maintain electric traction at 100% in Goonyella where this remains operationally and commercially beneficial, and to maintain fleet deployment flexibility by operating both diesel and electric traction in Blackwater.

This will result in the most efficient, lowest cost electric traction in both Goonyella and Blackwater through lower overall electric traction costs.



3. Annual AT5 increases limited to 5%

QR Network proposes that annual increases in AT5 that are the result of prior year under recovery should be limited to 5% per annum. Any unrecovered amounts would be carried forward for recovery in a following year. The aim of this mechanism is to smooth the volatility of AT5 tariff between years, by allowing QR Network to spread the recovery of costs over a number of years.

QR Network has indicated that it would only be willing to risk deferring revenue recovery if the proposed single AT5 and electric utilisation rebate mechanism are implemented to provide it with certainty that the revenue will be eventually recovered.

QR National supports the proposal on the basis that it helps to limit the pricing differential between electric and diesel traction and smooth volatility in the AT5 tariff component. Experience has shown that a large short term price differential between electric and diesel traction can distort the incentive to operate electric traction, even when the long term efficiency benefits are known. We consider it essential for the access arrangements to support incentives for electric traction as the least cost, most efficient outcome.

4. Access charges for diesel services - mainline enhancements

QR Network proposes that where new train services from non-electrified connections result in the need for new mainline capacity enhancements, the cost of electrifying that additional mainline capacity will be recovered from those new diesel services.

QR National agrees with the concept that a party which imposes incremental costs on the system should bear those costs. QR Network has indicated that the current access pricing arrangements do not automatically allocate the incremental costs that new diesel traction imposes on the system, to those diesel train services.

The introduction of the proposed single AT5 tariff and the electric utilisation rebate mechanism would not capture these costs, as they apply only to AT5. Train services from non-electrified connections are not subject to AT5.

QR National agrees with QR Network that pricing of diesel traction should be cost reflective and that the full costs imposed on the rail system by a diesel service should be paid by diesel users. As noted above, QR National also considers the capacity multiplier should be reviewed to ensure it accurately reflects the capacity impacts of non-electric traction choices on the system.

In conclusion, I would reiterate that QR National supports the objectives of the proposed DAAU which is to ensure optimal electric traction utilisation in both the Goonyella and Blackwater systems. We remain committed to working with QR Network, as well as system users and operators to achieve these outcomes.



Should you wish to discuss any aspect of this submission, please do not hesitate to contact either David Hamblyn on (07) 3235 3929 or Robin Laver on (07) 3046 9516.

Yours sincerely, /



AM

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