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John Hall
Chief Executive Officer
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Dear John

Electric Traction Pricing Draft Amending Access Undertaking (DAAU)

Thank you for the opportunity to comment both on the recent submissions from Queensland Coal industry members and non-members alike, the original QR Network submission (submitted 16 December 2011) and subsequent information.

The Electric Traction Pricing DAAU is a result of QR Network entering into this investment (the electrification of the Backwater system) with the full knowledge that they would be limited in the number of electric consists the system would be able to support. Under the proposed DAAU, producers are now being asked to effectively compensate QR Network for their poor investment decision. In the current environment where QR Network are seeking above regulated returns on expansion projects (i.e. WIRP1, WIRP2 and GAPE), Xstrata is fundamentally opposed to also being asked to compensate QR Network for poor investment decisions.

It is Xstrata's view that this application has been considered for long enough and that the QCA has sufficient information before them to make a final decision. With regards to the recent responses on the QCA's draft decision, 70% by number and approximately 90% by volume (tonnes) of Queensland coal producers support the QCAs draft decision **not to approve** this DAAU.

Xstrata welcomes the views of the companies such as Siemens, China Railways, Bombardier Transport and Infigen Energy who have not previously participated in this process. We note however that their positions are clearly based on a vested interest in a favourable determination of the DAAU, yet they bear none of the cost that the DAAU would impose onto the coal industry. Additionally Xstrata understands that further submissions may be potentially provided to the QCA by diesel-electric manufacturers, balancing the views expressed by the companies mentioned above. We also note that further submissions from Arup and Aurecon were paid for by QR Network, and therefore cannot be considered as genuinely independent views. Xstrata believes that if the QCA intends to form a definitive opinion on the merits of diesel vs. electric traction, that this view must be commissioned independently by the QCA, that it must be based on expert opinion, and that it must consider the likely future developments in both electric and diesel traction technology. No such independent or impartial opinion has yet been provided to the QCA as part of this process.

Xstrata has a substantial footprint within the Queensland Coal Supply Chain and advises that if this DAAU were to be approved it would have a material adverse impact on the Xstrata business. This submission responds to the key questions posed by the QCA in their letter addressed to QR Network, dated 08 October 2012, as well as raising additional points. In particular, Xstrata considers that:

- The argument provided by QR Network that electric technology is more efficient than diesel technology has not been adequately proven, and there are clearly differing views amongst those making submissions as to this point. If necessary, Xstrata believes that the only way that the QCA can make an unbiased determination is by obtaining genuinely independent and expert analysis, which examines the merits of the two technologies and also considers future evolutions of these technologies.

- The DAAU breaches the principles underlying the *Object of pt 5* (of the QCA Act) as the DAAU does not promote effective competition in upstream and downstream markets – in fact Xstrata asserts that the effect of the DAAU would be to stifle competition which has only recently been introduced to the above rail markets in QLD.

- The QR Network suggestion that Pacific National purposely inundated the Blackwater system with Diesel locomotives to pass on higher costs to QR Network is flawed. The reality is that the limit on the supply of electricity to the network has meant that producers could only contract for additional rail haulage services using diesel technology. This is something that QR Network was aware of at the time of making its initial investment in electrification of the Blackwater system.

- QR Network could be using other means to encourage use of the electric network, such as by lowering the AT5 tariff.

- The DAAU would greatly favour the above rail business of QR National at the direct expense of its main competitor Pacific National, and Xstrata believes that QR Network has behaved in an anti-competitive manner and may have breached the ringfencing obligations of the undertaking in making this proposal. The QCA must be satisfied, and should use its investigative powers to confirm, that these ringfencing provisions have not been breached.

- Approving the DAAU would also introduce regulatory risk that the 'rules of the game' may change at any time, thereby eroding confidence of users of the rail infrastructure when entering into long-term high cost infrastructure investments.

→QCA to obtain independent expert analysis of the merits of Diesel vs. Electric technologies

Underpinning the QR Network DAAU hypothesis is that total cost of ownership is at its lowest when there is a very high utilisation (above 90%) of Electric consists operating within the Blackwater System. XCQ is concerned that the QR Network analysis:

- ➢ fails to comprehensively and independently evaluate the relative operating costs of Electric vs. Diesel traction. Xstrata notes that the above rail operators do not unanimously agree that Electric consists have a long-term cost advantage over Diesel. At least one of the current operators has raised concerns that the analysis presented by QR Network is inaccurate and/or largely unsubstantiated; and

- ➢ fails to consider the new technologies that are under development (including new generation diesel engines and gas fuelled engines) and the performance of current Diesel locomotives against an ageing Electric fleet. Although the Electrics benefit from shorter provisioning times, these benefits are largely eroded by scheduling issues (i.e. Callemondah yard congestion, North Coast Line traffic, traffic management principles and downtime between consist readiness and next departure (actual) slot).

Xstrata is concerned that if the underlying analysis on the cost advantages of diesel vs. electric is not comprehensive and well supported, than the proposal to convert to an electric dominant operating model will actually impose a higher cost and sub-optimal outcome on users of the network.

Xstrata notes QR Network's assertion in its submission responding to the drafting decision that Xstrata has misunderstood the assumptions used in QR Network's TCO Model and that in order to avoid distorting the analysis technological improvements in diesel technologies should be excluded. Xstrata understands that is what QR Network has assumed. However, in any total cost of ownership analysis being used for the purposes of adjusting future pricing (which QR Network itself recognises impacts on decisions producers make about long term contracts) it must be appropriate to take into account the likely improvements in both alternative locomotive technologies during at least the period equivalent to the typical length of such contracts (i.e. approximately 10 years).

→ Object of Part 5 (of the QCA Act) and the public interest in competition

Part 5 states "*the object of this part is to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets*". Xstrata's view is that QR Network initially satisfied part 5 by electrifying the network so as to provide a choice between diesel and electric technologies. However the DAAU proposal, which aims to penalise diesel technology and discriminate in favour of electric technology, is fundamentally anti-competitive and discriminates in favour of QR National's own above rail business which has significant unutilised electric locomotive capacity. Therefore, having regard to the object and the public interest in having competition in markets (as required by section 138 QCA Act), it is not appropriate to approve the DAAU.

→Strategic Conduct

Xstrata rejects the suggestion by QR Network that a particular above rail operator (Pacific National) strategically increased the number of diesel locomotives as a way of passing on higher costs to the QR Network. For a long period of time, the number of electric locomotives the Blackwater rail network could support has been at its peak as a result of the limited electricity supply across the network. This has meant that producers seeking to contract for additional rail haulage services could only do so using diesel traction.

It is Xstrata's view that the market should retain its right to decide the most appropriate technology at the time of contracting. To approve the DAAU would effectively remove the choice in technology enjoyed today, distorting the market for above rail services and hindering the development of new and more efficient haulage technologies.

→Network stranded asset (lowering AT5)

QR Network's submission provides for a number of solutions on how to mitigate their potentially stranded electric assets, all of which pass on higher costs to the coal producer. Mechanisms for managing stranded asset risk are already provided for in the 2010 Access Undertaking and it is Xstrata's view that these options should be given more consideration.

Section 1.4 of Schedule A states that, "*the QCA should not require the value of the assets contained in the Regulated Asset Base to be reduced unless circumstances arise in the future where demand has deteriorated to such an extent that regulated prices on unoptimised assets would result in a further decline in demand*". Clearly, this provision can be applied to the Blackwater situation. QR Network could delay their return on their electric assets for a period of time which would drive the desired electric pricing signals. Xstrata considers this option, already suggested by a number of stakeholders in previous responses, to be the best way forward as it would send market signals that may drive a change in the current mix of diesel and electric locomotives within the Blackwater system.

→Potential breach of ring-fencing provisions

Taking into account the substantial number of unutilised electric locomotives owned by QRNational, it seems apparent to Xstrata that the DAAU would not only increase the utilisation of the QR Network electrical infrastructure, but would also increase the utilisation (and potential business) of QR National's electric locomotive fleet (and conversely hinder the prospects of Pacific National obtaining future business based on its predominantly diesel locomotive fleet). Given that the approval would provide a win-win for both QR Network and their related above rail operator, the QCA must not approve the DAAU unless it is absolutely satisfied that there have been no ring-fencing breaches, by either party, with respect to the development of the DAAU.

Xstrata continues to have serious concerns that the DAAU *was* specifically designed to favour QR Network's related above rail operator in the rail haulage market in contravention of the ring-fencing arrangements in Part 3 of the QR Network Access Undertaking. In particular, it appears that (via the DAAU) QR Network:

- is proposing to increase the effective costs of access for diesel train services (by incorporating in their access charges a component based on electric power usage which they do not utilise) in a manner which constitutes anti-competitive price or margin squeezing (which is a breach of clause 3.2(c) of the Access Undertaking); and

- was influenced by a related operator, in the design or decision to submit the DAAU, and therefore is not being managed independently of the provision of above rail services by related operators (which would be a breach of clause 3.1.1 of the Access Undertaking).

Xstrata also notes that a number of other stakeholders have raised similar concerns, either expressly as a concern about ring-fencing (see Asciano and Peabody submissions) or in terms of the DAAU adversely impacting competition in the above rail market (see submissions from Anglo, Asciano, BHP Billiton, Peabody, Rio Tinto, Vale and the Queensland Resources Council). Given the clear concerns of numerous stakeholders, Xstrata requests that the QCA use its audit and investigative powers under the Access Undertaking to determine whether the ring-fencing provisions of the Access Undertaking have been contravened.

Xstrata notes QR Network's submission in response to the draft decision which asserts that the adverse impact on Pacific National will be 'negligible' as it will be able to pass through access charges to coal producers. That argument only highlights the disadvantage the DAAU (if approved) would impose on Pacific National in terms of competing for new business where access holders will clearly take into account these access charges.

→ Requirement for QCA to include appropriate amendments in final decision

For completeness, Xstrata notes QR Network's assertion that the Authority has not complied with section 142(3) of the QCA Act by indicating in the draft decision that the way in which it considers it appropriate to amend the draft access undertaking is to delete all of the proposed amendments. Xstrata considers that approach is permitted by section 142(3) because the contrary interpretation raised by QR Network makes it impossible for the QCA to completely reject proposed amendments it considers are without any merit.

Xstrata considers the QCA has the power to do that and should issue a final decisions refusing to approve the DAAU in the same manner as it did in its draft decision.

→ Conclusion

Xstrata has invested significant time, money and resources in response to the DAAU which commenced in December 2011. 70% by number and approximately 90% by volume of the producers making submissions in response to the DAAU have been united and consistent in their rejection of the DAAU.

However, despite these consistent responses, QR Network has chosen to ignore the views of the coal export industry and to seek additional support from those outside the Queensland coal chain in an attempt to convince the QCA to overturn its draft decision. Despite these submissions, it is Xstrata's contention that the fundamental arguments have not materially changed and it is time for a final determination to be made. We therefore request that this process be concluded by the QCA and that the draft decision to reject the DAAU is upheld and made final.

Yours sincerely

[redacted]

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