

2 October 2012

Mr John Hall  
Chief Executive Officer  
Queensland Competition Authority  
Level 19  
12 Creek Street  
BRISBANE QLD 4000

Dear Mr Hall

### **Draft Decision on DAAU – Electric Traction Services**

This submission is provided in response to a request from the Queensland Competition Authority (**QCA**) for comments on its draft decision which proposes to reject the draft amending access undertaking (**DAAU**) submitted by QR Network Pty Ltd (**QRN**) on 16 December 2011 in relation to electric traction (**Draft Decision**).

Wesfarmers Curragh Pty Ltd (**Wesfarmers**) previously made a submission on the original QRN proposal and provides this submission in light of the QCA's Draft Decision to reject the DAAU.

### **Key concern with Draft Decision – Blackwater AT5 remains excessive**

In view of the QCA's Draft Decision, it is apparent that the QCA is minded to reject QRN's DAAU proposals (in the absence of compelling evidence or new arguments).

Wesfarmers' primary concern remains that current electric access charges in the Blackwater System (AT5) are at unsustainably high levels. The present regulatory pricing of electric infrastructure access is currently sending a strong price signal for Blackwater coal producers to contract diesel train services (that is, bypass the Blackwater electric assets) to avoid the excessive AT5 charges – even though electric traction is the most efficient traction choice at appropriate levels of utilisation.

It is Wesfarmers' view that the current excessive Blackwater AT5 rates must be immediately reduced.

While Wesfarmers is disappointed that the QCA's Draft Decision did not outline a way forward to address this issue, we remain hopeful that QRN will be able to provide a workable pricing framework that addresses both the immediate and long-term price signal issues currently exhibited on the Blackwater System. This provides a leadership opportunity for QRN to address this unresolved matter and Wesfarmers would support QRN in achieving such an outcome.

Wesfarmers confirms that this submission may be made publically available.

## **Importance of Blackwater AT5 price stability and certainty**

Regulatory pricing of access to the central Queensland electrification infrastructure should provide coal producers and above-rail operators with substantial regulatory certainty and price stability – generated by means of keeping AT5 rates competitive with diesel train services and providing a transparent price path. Given that long-term contractual and investment commitments have been made on this basis, there is considerable apprehension regarding the current situation on the Blackwater System.

The AT5 reference tariff that applies to QRN's Blackwater electric infrastructure has previously been set with regard to its overall level relative to diesel services, the objective being to ensure contestability of electric traction with diesel train services. To do otherwise would risk generating a price signal for above-rail operators to bypass the electric infrastructure service – this would not be a response of an efficient market.

During the finalisation of 2006 Access Undertaking, the Blackwater AT5 reference tariff was specifically reduced to ensure that it remained competitively priced with diesel following industry concern with the price signal generated by large increases in the Blackwater AT5 tariff. As recognised in QRN's submission to the QCA *Review of AT5 Pricing (2008)* report: *"In the UT2 process, QR's draft access undertaking proposed significant increases to the Blackwater AT5 tariff component, which was driven by revisions to QR's forecast consist mix (ie electric-diesel split). However, as part of this process, QR Network needed to defer recovery of some of its depreciation on the Blackwater system, in order to ensure that electric traction remained competitive with diesel on that system"*.

Moreover, the reductions made to Blackwater AT5 charges were based on a period of low expected utilisation during that regulatory period, with the expectation by QRN that electric utilisation would increase in future regulatory periods and any revenue reductions would be recovered when the expected increases in electric demand were realised. The intent of this approach was to smooth the price of access to the Blackwater electric infrastructure between regulatory periods by taking a pricing perspective beyond the immediate regulatory period.

Wesfarmers considers that QRN and the QCA should be able to develop an acceptable alternative to the DAAU which has the desired result of immediately reducing the excessive Blackwater electric access charges. QRN could responsibly address the immediate Blackwater AT5 price signal within the current regulatory regime by taking a long-term view of the Blackwater AT5 access charge. As a commercial enterprise, Wesfarmers would expect that QRN would prefer to reduce Blackwater AT5 prices in the short-term in order to maintain total recovery of the regulated revenues over the life of the electric infrastructure assets in order to avoid creating an asset stranding issue.

To the extent that QRN seeks to maintain the Blackwater AT5 rate above the contestable level of diesel traction services, then QRN not only risks encouraging more diesel services over electric on this system, it also provides greater support for stakeholders to seek the QCA to reduce QRN's Blackwater electric regulated asset base to achieve the same result.

## **Issues which must be immediately addressed**

Following a review of the Draft Decision, it is clear that the current arrangements for planning of and paying for electric traction infrastructure are not working in a way which is efficient or in the interests of all stakeholders. The QCA has acknowledged that the problems with the current situation include:

- **the AT5 price in the Blackwater System has been variable and apt to discourage use of spare capacity (and is therefore not economically efficient) (Draft Decision, 2.4 at p21);**
- **the reference tariff structure may not appropriately reflect the impacts of different types of train use (including diesel/electric use) (Draft Decision, 2.2 at p14); and**
- **in general, there is misalignment between customers' preferences in relation to electrification of the rail infrastructure and QRN's investment in and management of electric traction infrastructure (Draft Decision, 3.3 at p40).**

Wesfarmers supports the QCA's view that the above are problems which should be addressed and considers that future regulatory decisions should outline appropriate solutions.

A critical issue for Wesfarmers is the appropriate allocation of demand risk for electric investments to QRN. This is discussed further in sections 2 and 3 below.

#### **The detriment if these issues are not addressed**

Since the development of the initial 2001 Access Undertaking and at subsequent periodic reviews, the pricing of access to the central Queensland electric infrastructure service has been an important consideration for coal producers as regulatory electric pricing has been incorporated directly into above-rail contractual structures.


Customers such as Wesfarmers have implemented their current rail arrangements on the basis of the Blackwater System being a predominantly electrified system, with there being no apparent pricing incentive for QRN to set AT5 rates excessive relative to diesel (given this would promote competing diesel train services for new or renewing customers).

As noted in Wesfarmers' DAAU Submission, Blackwater System customers have had some visibility of QRN's intended investments in the system through the CRIMP process. However, Wesfarmers acknowledges the points made in other submissions and in the Draft Decision that QRN:

- **made a business decision to make substantial investments in electrification; and**
- **has acknowledged that this requires QRN to assume the risk of asset optimisation (in order to avoid creating an asset stranding risk) if QRN's expected demand for electrification did not materialise.**

It is Wesfarmers' view that, QRN must seek to immediately introduce measures to reduce the current inefficient Blackwater AT5 access charges in order to avoid QRN being in the unenviable situation of having invested in infrastructure which is then priced at a level that creates insufficient demand. In the absence of QRN taking appropriate action, the asset stranding risk should not be borne by a decreasing pool of remaining electric customers on the Blackwater System. This situation must be avoided.

It would be inequitable for Wesfarmers and other remaining Blackwater electric system users to continue to be the sole parties who are required to pay for investment in this infrastructure. In addition to being inequitable, it is also an inefficient result, as it requires the users of a service which is over-supplied (ie the electric infrastructure) to pay an unreasonably high price



for this use, therefore incentivising these users to find other alternatives as soon as possible. The Draft Decision notes that this is not an appropriate result. (Draft Decision, 2.4 at p21)

### **Wesfarmers' views on the appropriate response to the issues presented**

There are existing mechanisms in UT3 to address over-investment in assets for which demand has not eventuated. The current situation is precisely the type of circumstance that these mechanisms are intended to address, although Wesfarmers anticipates QRN will seek to implement a long-term, stable and certain price signal in order to promote increased utilisation of the electric infrastructure into the future and Wesfarmers intends to work with QRN to the extent possible to achieve this outcome.

#### The context in which QRN investment decisions were made

QRN made business decisions (as part of its integrated railway operations) to invest in electric infrastructure in the Blackwater System. While Blackwater users had some visibility of this proposal via the CRIMP process, users were able to take considerable comfort from the regulatory arrangements and QRN statements that event that the forecasts electric demand did not eventuate, then investments would be subject to possible optimisation.

#### The possible responses

In the absence of a suitable outcome via a collaborative approach as referred to at the start of this section 3, alternative responses to this issue appear to be about how demand risk is to be allocated. In our view, there appear to be three possible responses:

- all users bear (socialised) demand risk – this would be the result if the QCA were to approve the DAAU;
- the Blackwater System electric users bear demand risk – this would be the case if the QCA were to reject the DAAU; or
- QRN bears demand risk – this would be the case if the QCA were to reject the DAAU and require the value of relevant Blackwater electric infrastructure expenditure to be optimised.

The second response would result in the detriment outlined in section 2 above. In addition, it would:

- undermine regulatory certainty, as it will mean that the conditions of access under which Wesfarmers and other concerned users are different to those at the time relevant commitments were made (a higher AT5 tariff and the underutilised electric expenditure not being optimised, despite what was foreshadowed by QRN);
- increase the level and impacts of asset stranding risk, as it will merely incentivise more users to abandon electric traction in favour of more viable alternatives.

#### The appropriate response

We understand the main argument for not implementing a response based on optimisation is that Blackwater electric infrastructure investment has been pre-approved via the CRIMP process. Both the QCA in the Draft Decision and other stakeholders in submissions on the DAAU have questioned the fulsomeness of the CRIMP process and in particular whether

customers received enough information to provide meaningful approval. It is noted that the QCA 'does not consider it appropriate to *unnecessarily* expose [QRN] to asset stranding risk on the basis of expressions of dissatisfaction with the [CRIMP process] after the event', unless there was some clear deficiency in the CRIMP process itself. (Draft Decision, section 33 at p40, emphasis added)

In Wesfarmers' view, optimisation would not *unnecessarily* expose QRN to asset stranding risk. Rather, it would implement the very response which QRN contemplated at the time of making the investments and which was commonly known by users. The alternative is to expose a small pool of users – who made their decisions by reference to QRN's stated intentions – to the risk. This does not seem to be an equitable result or one which is consistent with UT3 or the regulatory regime.

Going forward, the issue of how to align investment in infrastructure with user demand obviously deserves more attention. This is in the interests of both QRN and existing and future customers. It would be appropriate that this occur in the lead-up to UT4.

## Conclusions

In summary:

- **Wesfarmers recognises the QCA's intention to not approve the DAAU.**
- **Wesfarmers will continue to work with QRN, the QCA and other stakeholders to ensure that a long-term, stable and certain Blackwater AT5 price signal promotes increased utilisation of the electric infrastructure into the future.**
- **Wesfarmers does not believe it is an appropriate result for the remaining Blackwater electric users (with long-term contractual commitments) to solely bear demand and asset stranding risk for assets which QRN has chosen to invest in.**
- **Wesfarmers supports the QCA retaining the ability to optimise the value of relevant electric expenditure, in order to avoid creating an asset stranding risk for QRN.**
- **Wesfarmers supports and wishes to engage with QRN and other system stakeholders in a process to better align future investment with user demand.**

We would be happy to expand on any of the views expressed in this submission and to participate in further discussion on the issues raised.

Yours sincerely

  
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