



07 June 2013

Mr Paul Bilyk

Director, Rail and Ports
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

By Email: To: rail@qca.org.au

Dear Mr Bilyk,

Aurizon Network's 2013 Blackwater Electric Traction Pricing Draft Amending Access Undertaking

Vale Australia Pty Ltd (**Vale**) welcomes the opportunity to provide a submission to the Queensland Competition Authority (**QCA**) in respect of the 2013 Blackwater Electric Traction Draft Amending Access Undertaking (**DAAU**) submitted by Aurizon Network Pty Ltd (**Aurizon**), dated 24 April 2013.

Capitalised terms in this letter have the meaning given in the 2010 Access Undertaking (**Undertaking**) unless otherwise defined.

Executive Summary

The appropriate mechanism used for the recovery of electric costs has been discussed at length during prior undertaking reset processes and the previous 2011 QR Network Blackwater Electric Traction Services Draft Amending Access Undertaking (**2011 DAAU**). Vale has been an active participant in industry discussions regarding this matter and has provided submissions to the QCA as part of the consultation process for the **2011 DAAU** which was rejected in the July 2012 draft decision by the QCA, and later withdrawn by Aurizon in January 2013.

Aurizon asserts that the current AT5 tariff is flawed as it has resulted in the access price distorting the traction choice in favour of diesel, and threatening not to provide Aurizon with revenue adequacy. Aurizon has argued that the AT5 tariff does not meet the requirements of the object of Part 5 of the QCA Act yet there is no long term structural change in the pricing mechanism. Vale also does not support Aurizon's DAAU claim that the current AT5 pricing mechanism is inconsistent with the QCA Act. Vale believes that the short term pricing adjustment being proposed by Aurizon, in this DAAU, increases the risk to stakeholders as it does not provide a clear understanding of the pricing structure mechanism for any future development of the electric network. The proposed change in the pricing mechanism appears to only provide a solution for Aurizon's revenue adequacy, which is based on a perceived extreme risk of asset stranding. Vale does support a lowering of the AT5 price which should encourage further use of electric traction, but it does still have some concerns about the Under Utilisation Payment (**UUP**) mechanism being proposed. Vale does not believe it would be appropriate for all Central Queensland Coal Network (**CQCN**) users to be required to fund any proposed UUP as they did not have any opportunity to Vote on this project during the CRIMP process.

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Background

In the current DAAU Aurizon claims that the current AT5 mechanism has resulted in an access price that is:

- inefficiently high, distorting traction choice in favour of diesel; and
- threatening not to provide Aurizon Network with the revenue adequacy that the mechanism was intended to provide

Aurizon asserts these flaws with the mechanism are inconsistent with Section 69E in Part 5 of the QCA Act and inconsistent with the QCA's commitment to avoid the stranding of the Blackwater electrification assets.

Vale provides the following details to clarify its position.

Compliance to the Act

Aurizon asserts that the current AT5 tariff is flawed as it has resulted in the access price distorting the traction choice in favour of diesel, and threatening not to provide Aurizon Network with revenue adequacy. Aurizon asserts the distorting nature of the access price is inconsistent with Section 69E in Part 5 of the QCA Act as it does not "...promote the economically efficient..... use of..... significant infrastructure....".

Aurizon's premise for meeting the object of Part 5 is based on the efficient use of the infrastructure. Aurizon has substantiated this claim with reference to the total cost of ownership model that was presented in the 2011 DAAU. The total cost of ownership model was debated at length during the 2011 DAAU consultation period and the QCA, in its draft decision of July 2012, determined that

"The Authority considers that QR Network has not made a convincing case to verify its claim that electric traction is more efficient than diesel."

Given Aurizon has not introduced any further information on the total cost of ownership model in this DAAU, to substantiate this efficiency claim, Vale cannot agree that Aurizon meets this requirement, and has established an economically efficient use of the electric infrastructure, as per the object of Part 5. The only further claim that Aurizon has made to support the efficiency of electric traction is the reference to the electric utilisation on the Goonyella System being nearly 100%. Vale believes, using Goonyella as a reference is very subjective as a counter argument can be made with reference to the Newlands, Moura, and the Western Systems all remaining diesel only operations. It also ignores the Hunter Valley coal network, which has significantly greater tonnages to each of the systems in Queensland, still remaining a diesel only operation.

Vale believes that the DAAU also does not support the object of Part 5 of "...economically efficient... investment in significant infrastructure". Vale believes the pricing mechanism that has been developed does not provide a clear and consistent mechanism which will assist Access Holders during future discussions on upgrading or developing electric infrastructure. The pricing mechanism appears to only provide a temporary mechanism for change but does not change the underlying mechanism that Aurizon claims is flawed. If Aurizon believes the AT5 tariff is flawed then Vale would believe this requires a structural change rather than a temporary adjustment to the existing mechanism.

Vale believes this is supported by the draft decision of the QCA which stated (on page 5)

"The Authority acknowledges QR Network's argument that AT5 is an average cost price and therefore may send inappropriate signals for the efficient utilisation of the overhead electric network. However, the AT5 DAAU has not sought to adjust the way AT5 is derived to provide more appropriate signals that reflect marginal costs or the likely pattern of usage over the life of the assets. As noted above, these issues require further consultation."

Under the DAAU there are no structural changes to the long term pricing of the AT5 tariff which addresses this concern. Vale believes that if no structural changes are made to the AT5 tariff the DAAU pricing mechanism is unlikely to provide appropriate signals that reflect the marginal costs or the likely pattern of usage over the life of the assets as identified by the QCA in its draft decision.

The second concern raised by Aurizon is that the access pricing mechanism does not provide it with revenue adequacy consistent with Section 168A(a) in Part 5 of the QCA Act. Aurizon has not identified an inconsistency between the current mechanism and Section 168A (a), but rather it is “threatening not to provide”. Given the structure of the AT5 tariff is not fundamentally changing, Vale is uncertain why Aurizon can assert that the pricing mechanism is inconsistent with section 168A(a). Aurizon is proposing a temporary adjustment to the pricing mechanism which reverts to the current pricing mechanism in the longer term. Vale does not believe Aurizon can make a claim for the pricing mechanism to be inconsistent to the Act if it does not propose to change the way the AT5 tariff is derived.

Aurizon has acknowledged on page 3 of its explanatory notes that

“In the extreme, this could make electric haulage entirely uncompetitive, stranding the electrification assets”.

Aurizon does not provide cogent evidence it is currently unable to generate expected revenues as required under Section 168A(a). Aurizon has also not identified a current risk that is upon them but is rather concerned about an extreme risk. Therefore, Vale believes Aurizon has failed to substantiate that the current AT5 tariff is not generating the expected revenue for the service.

Pricing Mechanism

Vale is concerned this proposal does not address the long term AT5 issues. Aurizon notes in its paper that electric traction must be efficient as Goonyella was developed as a fully electrified system. Vale inherits this position on the Goonyella system but also notes that neither the Moura or Newlands Systems, or the newly constructed Northern Missing Link are electrified, which raises the question over Aurizon’s claim that electric traction must be efficient as Goonyella is fully electrified. Vale is concerned that if a decision is made to accept this mechanism for calculating AT5 it will create uncertainty relating to future expansions of the electric traction infrastructure as the mechanism cannot be applied in the future due to its subjective nature. Vale believes a pricing mechanism should be established that provides pricing certainty to both the Blackwater and Goonyella system users for any further electric capital upgrades, as well as any potential electrification of the Moura and Newlands Systems

Vale does not believe that the current pricing structure encourages long term efficient operation of and investment in the electric infrastructure due to the short term mechanism that has been proposed. Vale is not opposed to a mechanism that is used to develop a fixed AT5 tariff that is based on a long term view of electric infrastructure pricing and believes this is an appropriate approach to allow the recovery of an investment when the utilisation of an asset is low. Given the previous electric infrastructure constraints on the Blackwater System, the long term above rail contracts, and the time to purchase new rolling stock, it will take some time to generate higher electric utilisation. Vale supports the approach to capitalise the investment not recorded in that year into the Regulated Asset Base. This mechanism is similar to the system that is being utilised by ARTC, for Zone 3 pricing, in the Hunter Valley. In the Hunter Valley a lower price is established to consider that lower tonnages being railed as the coal basin continues to grow and expand. The revenue that is not recovered via access tariffs in a year is capitalised in the Regulated Asset Base and earns a regulated rate of return.

Vale does not support the UUP as it believes this does not promote the economic efficient use of the infrastructure. Vale believes the current approach to socialise the costs, via the UUP, will be too easily triggered and result in a socialisation of the costs across all Blackwater users, assuming the implementation of the Aurizon preferred option. Under the DAAU the UUP is triggered if the electric tonnages do not achieve 85% of the maximum feasible egtks. Vale is

concerned about the ability to meet this 85% trigger given the previous electrical infrastructure constraints in the Blackwater System, The electric infrastructure assets that have initiated Aurizon's DAAU were constructed to allow more electric trains to run on the Blackwater System. Until this time a stakeholder was limited in what traction choice it had on the Blackwater System and as a result Vale assumes that many long term contracts have been established to operate diesel traction which will limit the ability of the system to ever achieve 85% of maximum feasible egtks in the short term. Vale believes an approach that is not restricted by a future time limit or short term triggers provides the appropriate mechanism to ensure the tariffs are cost reflective and provide appropriate long term signals for future electric infrastructure development.

Vale also does not support the DAAU as the mechanism regarding the recovery of the proposed UUP is not clear. Aurizon has identified 3 alternative mechanisms to recover the UUP, with one as the preferred option. Schedule K, that has been provided to the QCA has the drafting of the proposed users subject to the UUP in square brackets. Vale is supportive of receiving information on potential options that have been considered by Aurizon when determining the DAAU, but it must be clear which option Aurizon is proposing. Vale believes that consideration of options should be completed via consultation prior to any submission to the QCA. Upon completion of this consultation period the DAAU should clearly state the proposal considering the feedback and determining the most economically efficient outcome. Aurizon has currently stated that option 1 is the preferred approach to allocating the UUP. Vale is unclear whether Aurizon is seeking further views on the proposed UUP options in the DAAU, but Vale does not support any suggestion to socialise the costs of the Electric traction across the CQCN as participants outside the Blackwater system have never had the opportunity to vote, during the CRIMP process, on the proposed infrastructure and the asset is currently not subject to optimisation.

Vale also believes that discussions of optimisation, and therefore, WACC adjustments, are far too premature to be discussed in this DAAU as the electric infrastructure has only just been constructed. Vale does not believe it would be appropriate to implement a mechanism to address the alleged stranding risk at this stage as even Aurizon have stated, in their submission, that this stranding risk is only an extreme case.

Consultation

Vale has raised in previous submissions to the QCA Vale's concerns that it has with the consultation process conducted by Aurizon. In the Aurizon submission it provides a list of producers that it met within Appendix A. Vale believes that the inclusion of this appendix in the document infers that communication was completed with the listed stakeholders. Vale confirms that it did have a single meeting with Aurizon and at this meeting did express many views about the 2011 DAAU and the presentation discussed at the meeting. Since this time Vale has not received any further communication relating to the minutes of that meeting or any response to any of the issues raised. Vale is concerned that the consultation approach by Aurizon still appears to be very limited even in the lead up to the development of the UT4 document which proposes consultation with stakeholders as the most efficient approach to resolving regulatory issues.

For further information regarding this advice please contact myself on 

Yours sincerely,


Bob Skuza
General Manager Logistics
Vale Australia Pty Ltd