Professor Flavio Menezes
Queensland Competition Authority
Level 27
145 Ann Street
Brisbane QLD 4000

Submission on QCA's Draft Decision on Aurizon Network's Electric Traction (AT5) Draft Amending Access Undertaking (AT5 DAAU)

29 June 2018

Dear Professor Menezes,

Aurizon Coal welcomes the opportunity to respond to the Queensland Competition Authority's (**QCA**'s) Draft Decision on Aurizon Network's Electric Traction (AT5) Draft Amending Access Undertaking (**AT5 DAAU**). This submission is intended to be read in conjunction with Aurizon Coal's previous submission on the AT5 DAAU dated 8 February 2018.

Aurizon Coal has identified components of this submission which are confidential, and Aurizon Coal requires the QCA to keep confidential those parts of its submission which could have the potential to damage its commercial interests on the basis the information is representative of market or strategic knowledge.

Aurizon Coal agrees with the QCA that a proposal to provide for socialisation of the ongoing costs of Aurizon Network's electric infrastructure can promote the economically efficient operation and use of, and investment in, the relevant networks by assisting to mitigate asset bypass and asset stranding risks, including by dampening an AT5 price spiral.

The Draft Decision represents a valuable step forward on an issue that is overdue for resolution. This issue needs to be resolved quickly and in a way that puts an end to the uncertainty regarding the longevity of traction choice that has been plaguing decision making on capital expenditure for electric assets.

Aurizon Coal notes the QCA's concerns regarding the proposal as submitted by Aurizon Network and our comments are limited to those matters which require attention, namely, the risk of traction switching, the measure for electric utilisation, the threshold levels for application of the electric revenue adjustment and the investment framework.

1. Switching Traction Types

Aurizon Coal does not accept the view that "*it is unlikely that any distortions from the existing AT5 approach will result in significant bypass or stranding in practice, especially in the short- and medium* *terms*".[1] Aurizon Coal maintains that AT5 is highly sensitive to electric utilisation and small changes in electric utilisation cause incongruent shifts in the cost of AT5 and, in turn, the competitiveness and longevity of traction choice. Whilst investment decisions are long term in nature and not made in response to short term price incentives, opportunities to switch can be incremental and are invariably based on the information and risk profile known at that time. This means that small incremental changes to traction choice are possible due to specific rollingstock asset lives and/or contracting timeframes. Additionally, in the Central Queensland Coal Network where operators have large mixed fleets, opportunities to switch also present when there are overhaul requirements to maintain locomotive capability or extend rollingstock life. These small changes have a cumulative and disproportionate effect on the cost and competitiveness of electric traction ultimately distorting price signals and competition in above rail markets. This means bypass of electric traction can occur incrementally without a 'lumpy' wholesale traction switch, which goes to the appropriate threshold levels for socialisation (see below).

Aurizon Coal acknowledges that there are circumstances where switching traction type can be problematic and there are hauls which, due to location or operation type, cannot operate electric traction. However, Aurizon Coal considers these hauls to be limited in nature and is not a primary factor in determining the likelihood of switching in the near to medium term.

2. Measure for Electric Utilisation and Threshold Levels for Socialisation

(a) Appropriate measure

Aurizon Coal believes that eGTKs is the best measure for electric traction utilisation, particularly given the AT5 pricing mechanism utilises that unit of measure. Aurizon Coal notes the QCA's concerns in relation to using eGTKs as a measure but considers provided the measure is calculated without reference to non-electric growth volumes, the QCA's concerns can be addressed. Reverting to another measure such as system volumes would similarly be influenced by increases in non-electric growth volumes. Measures outside of eGTK would also not consider the impact of traction switching of longer hauls to the price of AT5 and associated stranding risk.

(b) New entrant volumes

Aurizon Coal considers that any incremental costs of socialisation arising from new entrant volumes would be minimal and would not be a sufficient barrier to diesel entry. The costs of socialisation in these circumstances needs to be weighed against the costs associated with any stranding event triggered and have regard to the uneven playing field between diesel and electric traction that allows electric traction prices to be distorted under the current pricing framework. Traction neutrality therefore should not be pursued at the expense of addressing the current distortion of electric traction pricing and avoiding asset stranding risk of electric traction assets as a whole.

Despite this, Aurizon Coal is not opposed to excluding new entrant volumes from any measure as long as any exclusion only relates to true new growth volumes such that any actual bypass is not masked. In our view, true growth does not displace existing volumes. That is, existing electric utilisation remains as is and continue without that new volume entering the market and AT5 costs (and associated risk of electric bypass) would not be increased by virtue of their entry. For clarity, replacement of end of mine life volumes with alternate volume should not be considered true growth and existing volumes should be defined as all access rights currently contracted with Aurizon Network in the Blackwater and Goonyella system.

[1] Queensland Competition Authority, Draft Decision on Aurizon Network's 2017 Electric Traction DAAU, May 2018, p 13.

(c) Threshold levels

Aurizon Coal disagrees that the threshold levels as proposed by Aurizon Network are too high nor (given the likelihood of traction switching noted above) are they designed to sustain electric traction rather than avoid true bypass and stranding risk.[2] Continuing the sustainability of traction choice, particularly when AT5's average cost mechanism causes high sensitivity to electric utilisation, is important to underpin long-term investment by all rail operators in electric traction.

The threat of bypass in Blackwater is real even at current utilisation rates.[3] In Aurizon Coal's view, Blackwater is yet to achieve the requisite economies of scale to reach its average long run prices. [redacted] Traction switching under these expiring haulage contracts will be driven largely by the current differentials in diesel and electric costs[4] and its resulting impact on customer's traction preferences.

[redacted]

Aurizon Coal does not fault the QCA view that the mechanism should only seek socialisation when asset stranding is a likely outcome. Asset stranding becomes a likely outcome when incremental opportunities to switch arise and cumulatively over time trigger stranding. Aurizon Coal considers this is the case in both Blackwater and Goonyella.

The QCA's concern regarding non-bypass related shocks to electric utilisation causing socialisation is noted, however, Aurizon Coal believes that any socialisation resulting would be minimal. If it is not a true switch in traction, any reduced utilisation would be absorbed and its effects smeared across the annual measure proposed to be used. As such, this should not be a principal determining factor in lowering the threshold amounts although Aurizon Coal is supportive of any clarifying amendments to the mechanism to ensure this is the case.

As the QCA notes, there is likely to be a range of measures and thresholds that might be appropriate,[5] and Aurizon Coal believes that the exact tipping point of asset stranding risk is not determinable to an adequate level of confidence due to the range of assumptions and confidence in each of those assumptions required.[6] Once asset stranding is realised, there is no return and Aurizon Coal believes erring on the side of caution with any threshold level is appropriate where the expected cost of doing so are relatively low. This should particularly be the case when comparing tothe counterfactual (namely, asset stranding).

3. Application across regulatory periods

AT5 is unlike other components of Aurizon Network's pricing in that it can be bypassed and so is inherently more uncertain than other components of the reference tariffs. It is imperative that there is certainty in the regulatory pricing framework given the long-term investments that underpin above rail electric assets. Aurizon Coal considers any changes to AT5 pricing should span across regulatory

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[2] Queensland Competition Authority, Draft Decision on Aurizon Network's 2017 Electric Traction DAAU, May 2018,, p 25.

[3] See Aurizon Operations' previous submission dated 17 February 2018 on electric traction submitted in response to the Aurizon Network 2017 DAU.

[4] Ibid.

[5] Queensland Competition Authority, Draft Decision on Aurizon Network's 2017 Electric Traction DAAU, May 2018,, p 25.

[6] E.g.. operators' individual rollingstock decisions, assessment of future input costs and risk appetites.

periods or have, at a minimum, a structure which provides operators a requisite level of certainty in pricing frameworks. This should not preclude the ability for the QCA, through the normal regulatory process, make amendments to the mechanism or framework to respond to circumstances, including market factors at a particular point in time.

4. Investment Framework

Aurizon Coal is supportive of having a clear and transparent framework for approving future investment in the electric traction network, specifically a robust pre-approval process. This pre-approval process should involve all impacted access holders and operators. Greater voting rights should also be given to operators as the parties who have significant complementary investments in electric assets. One way this could be achieved is by allocating 50% of the voting rights to operators which is then allocated in accordance with each operators' nominated access rights.

Additionally, to the extent any threshold is applicable such that only capital projects that exceed a certain capital cost requires pre-approval; this threshold should have reference to the total capital costs of all projects in any one year to reflect the cumulative effect of capital costs on AT5 prices.

5. Conclusion

Aurizon Coal is supportive of the QCA's assessment that allowing an electric revenue adjustment is appropriate in some circumstances, including to avoid electric asset stranding.

Aurizon Coal does not agree with the QCA's assessment that stranding risk in either the Blackwater or Goonyella systems in the near to medium term is not real and that the electric utilisation thresholds should be set below the current utilisation thresholds as proposed by Aurizon Network. The incremental but cumulative nature of traction switching opportunities in the near to medium term supports the setting of utilisation thresholds as proposed by Aurizon Network.

Provided Aurizon Network makes amendments to the mechanism to:

- exclude true new growth volumes as discussed above; and
- ensure non-bypass related shocks to electric utilisation measures do not trigger socialisation; and
- include a robust pre-approval process for electric assets.

Aurizon Coal believes the QCA should approve such an amended AT5 electric revenue adjustment mechanism.

If you wish to discuss any elements of this submission please do not hesitate to contact me at Louisa.Chung@aurizon.com.au.

Kind regards,

[redacted]

Louisa Chung
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Aurizon Coal