

Pacific National Submission to the QCA in Relation to the Aurizon Network 2017 Electric Traction DAAU

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1. Introduction

Pacific National welcomes the opportunity to make a submission to the Queensland Competition Authority (QCA) in relation to the Aurizon Network 2017 Draft Amending Access Undertaking in relation to Electric Traction (the Electric Traction DAAU). Pacific National appreciates Aurizon Network's engagement with Pacific National prior to its submission of the Electric Traction DAAU to the QCA.

As the QCA is aware, the matters of electric traction and the pricing of electric rail infrastructure have previously been considered by the QCA, most notably in relation to the Aurizon Network¹ 2011 DAAU on Sustainable Electric Traction Pricing. At the time Pacific National² made several responses to the 2011 DAAU and believes that many of the positions and findings of this previous regulatory process remain relevant to the QCA's consideration of the current Electric Traction DAAU.

In preparing this submission, Pacific National is mindful of the factors set out in the *Queensland Competition Authority Act 1997* (QCA Act) to which the QCA must have regard in determining whether or not to approve the Electric Traction DAAU. The QCA may only approve the DAAU if the QCA considers it appropriate to do so having regard to the matters mentioned in section 138 of the QCA Act. Pacific National submits that when taking into account the factors set out in the QCA Act, the QCA cannot approve the current Electric Traction DAAU as it fails to properly meet the relevant objectives and pricing principles of the Act.

This submission is public.

2. Background

As the QCA is aware, Pacific National is a major train operator on the Aurizon Network and transports coal on this rail infrastructure via both electric traction and diesel traction trains. The main competitor to Pacific National on the Aurizon Network is the Aurizon Operations above rail business, which is a related party within the Aurizon group. Pacific National currently regularly³ operates train services on the following Aurizon Network rail systems:

¹ At the time of the submission of this DAAU in 2011 Aurizon was operating under the name QR National

² At the time of the submission of this DAAU in 2011 Pacific National was a subsidiary of Asciano and submissions made by Pacific National to this DAAU were under the name of Asciano.

³ Pacific National operates on an ad hoc basis on the Moura System

Table 1: Pacific National Operations on the Aurizon Network

System	Electric Infrastructure	Pacific National Operations
Goonyella rail system	This system is electrified	Pacific National primarily operates electric locomotives but also operates some diesel locomotives.
Blackwater rail system	This system is electrified.	Pacific National operates diesel locomotives but is planning on commencing more regular electric locomotive operations in the near future such that the Pacific National mix will be approximately 80% diesel and 20 % electric.
Newlands – GAPE rail system	This system is not electrified.	Pacific National operates diesel locomotives.

Pacific National’s electric and diesel operations on the Aurizon Network infrastructure should be understood in the context of the history of these operations. Pacific National entered the Queensland coal rail haulage market in 2009. Prior to entering this market Pacific National had to make a decision as to whether to operate diesel traction locomotives or AC electric traction locomotives. At the time this decision was made in 2007 Pacific National was informed by an independent consultant, who was in discussions with Aurizon Network that, while the Goonyella system could accommodate AC electric traction locomotives, the Blackwater system could not accommodate AC electric traction locomotives due to power and signalling constraints. Consequently Pacific National made a twenty year investment decision to invest in diesel locomotives for Blackwater system operations. Pacific National notes that subsequent to this decision Aurizon Network upgraded the electric infrastructure in the Blackwater system.

3. The DAAU and the Regulatory Process

Pacific National notes that the Electric Traction DAAU has been made under the 2016 Aurizon Network Access Undertaking (UT4). At the time of preparing this submission the QCA has released its Draft Decision relating to the next Aurizon Network Access Undertaking (UT5). Given this overlap between the regulatory and consultation processes for the Electric Traction DAAU and UT5, Pacific National seeks that the QCA and Aurizon Network clarify how they envisage these two regulatory processes will interact. In particular Pacific National is seeking clarity on the process to apply where UT5 is finalised prior to the Electric Traction DAAU. In this instance, Pacific National assumes that a new Electric Traction DAAU would need to be lodged under UT5.

Pacific National has a broader concern with the timing of the Electric Traction DAAU and the UT5 regulatory process. Pacific National believes that the pricing and services offered in an Access

Undertaking should be assessed as a single package where these elements are interrelated such that decisions should not be made in isolation on any one element. Rather, a single decision is made which takes into account all elements. By separating out a single pricing element, such as the adjusting of tariffs for potential electric infrastructure under recovery, and making a decision solely on this element the integrity of the decision making process is compromised which can in turn lead to undesirable outcomes for all stakeholders.

Pacific National asserts that if the Electric Traction DAAU is approved, this will create uncertainty for access seekers and users, such that they cannot be assured that the Access Undertaking pricing will remain in force for the term of the Access Undertaking. This lack of certainty associated with future price paths has the potential to impact on efficient operations and investment by access seekers, access users and Aurizon Network.

Given the current Access Undertaking expires on 30 June 2018 and the next Access Undertaking is under active consideration by the QCA Pacific National believes that the pricing matters in the Electric Traction DAAU are best addressed through the current Access Undertaking review. Such an approach would ensure that matters raised in the Electric traction DAAU can be applied consistently across all aspects of Aurizon Network's operations, systems and pricing rather than be applied in an ad hoc manner to a single element of the pricing structure as is proposed in the Electric Traction DAAU. Irrespective of this, Pacific National believes that the pricing concepts and mechanisms designed to address electric infrastructure under recovery contained within the Electric Traction DAAU are flawed and should be rejected.

4. Aurizon Network's DAAU Proposal

The substantive amendments proposed by Aurizon Network in the DAAU are amendments to the *Access Undertaking: Schedule F: Reference Tariff Schedules*. In summary Pacific National understands these amendments to operate as follows:

- the introduction of a **Variable Connection Charge**, which is a variable charge associated with an electricity connection billed on an electricity consumption basis. This charge would be required to be approved by the QCA each year; and
- the introduction of an **Electric Revenue Adjustment**. This adjustment would be the lesser of
 - the AT5 revenue shortfall amount which occurs when AT5 actual revenue is less than the AT5 revenue allowed under the regulatory system; and
 - the amount derived by multiplying the following amounts:

- the AT5 tariff;
- the actual GTK; and
- the amount calculated as follows:
 - for the Goonyella system - 98⁴% minus (actual EGTK / actual GTK for the Goonyella system; and
 - for the Blackwater system 75% minus (actual EGTK / actual GTK for the Blackwater system

This Electric Revenue Adjustment is proposed to be recoverable through the AT3 tariff. That is the adjustment is recovered from all Aurizon Network users, including diesel users, by way of the revenue cap adjustment process.

Aurizon Network maintains that these amendments for the Electric Revenue Adjustment are required to address the following matters:

- Option pricing – Aurizon Network argues that the amendments are required to price the free option which they argue diesel traction users have when operating on the Aurizon Network rail infrastructure. That is, diesel traction users have a choice between electric and diesel traction where this choice is provided by Aurizon Network’s investment in electric infrastructure, and in particular current diesel users have the option to convert to electric traction in the future at no cost whereas electric traction users pay for maintenance of the electric traction infrastructure for all future electric infrastructure users. Aurizon Network⁵ holds that the option to choose between these traction modes provides a benefit to diesel users and a cost to Aurizon Network which is not reflected in current pricing.
- Potential for Inefficient Spiralling AT5 Prices – Aurizon Network argues that the amendments are required to address a perceived flaw in the current pricing approach. Aurizon Network assert that reduced electric traction usage would result in increasing AT5 prices which would ultimately result in a price spiral as increasing AT5 tariffs drive electric traction usage reductions which drive further increases in AT5 tariffs. Such a price spiral would impact on Aurizon Network’s ability to maintain its revenue.
- Obligation to Provide Electric Traction Infrastructure – Aurizon Network argues that the amendments are required as Aurizon Network is required to provide electric traction infrastructure regardless of its level of usage. This creates a stranding risk which cannot be

⁴ These constants of 98% in Goonyella and 75% in Blackwater are based on current electric infrastructure utilisation rates in the respective systems.

⁵ See for example Aurizon Network, Submission 2017 Electric Traction Draft Amending Access Undertaking, November 2017, page 4

avoided as Aurizon Network must maintain electric infrastructure even if it is not economically efficient to do so.

In summary Aurizon Network claim that the current AT5 tariff approach distorts price signals and create a risk of asset stranding for both electric infrastructure and electric rollingstock if electric traction utilisation levels decline. To address this concern Aurizon Network is proposing to socialise the potential under recovery of the AT5 electric infrastructure tariff across all users (including diesel users) when this under recovery is the result of changes in electric infrastructure utilisation.

Pacific National recognises Aurizon Network's concerns, but Pacific National is apprehensive about the proposed Electric Revenue Adjustment. These Pacific National concerns are outlined in section 4 below.

Aurizon Network is also seeking to introduce a Variable Connection Charge. The Variable Connection Charge will shift variable costs (such as electric transmission connection charges) from the AT5 tariff to the EC tariff. This will result in the AT5 tariff only reflecting fixed costs. At this time Pacific National has no fundamental concern with this re-alignment of costs between tariffs provided that it is executed in a transparent manner and the actual charges reflect costs incurred.

Pacific National understands that there is no proposal for "grandfathering" arrangements under the Electric Traction DAAU⁶.

5. Pacific National Concerns with Aurizon Network's DAAU Proposal

Pacific National continues to strongly support the principle that users of Aurizon Network rail infrastructure should have freedom of traction choice and these users should only be charged for infrastructure that they actually use. Pacific National believes that charging users for infrastructure that they do not use results in allocative inefficiency and price distortions.

In considering potential options to recover electricity infrastructure costs Pacific National strongly believes that any new options ultimately adopted should be forward looking and not penalise diesel users for traction choices made prior to the introduction of any revised electricity infrastructure cost recovery mechanism.

Pacific National's primary concerns with the proposed Electric Traction DAAU are outlined below.

⁶ Previous discussions regarding the matter of Aurizon Network and electric infrastructure cost recovery had included discussions as to whether current diesel locomotives would be exempted from any future regulatory requirements applying to Aurizon Network and electric infrastructure cost recovery.

- Inconsistent with Cost Reflective Pricing Principles – in order for infrastructure pricing to be efficient the pricing should reflect the cost of the infrastructure that the users actually use. Pacific National believes that the Electric Revenue Adjustment as outlined in the Electric Traction DAAU is inconsistent with this pricing principle as users who operate diesel traction services will potentially be paying for electric infrastructure that they do not use (and may never use). In particular diesel users will be paying to address the risk of electric infrastructure stranding, which is a risk that they have not accepted. Thus the proposed Electric Traction DAAU transfers risk from electric users to diesel users.

Further to the point of cost reflective pricing, applying the Electric Revenue Adjustment to the AT3 tariff will potentially result in the AT3 tariff no longer accurately reflecting the costs that it is intended to reflect and this in turn may further impact allocative efficiency. (In addition, while the AT5 tariff is not subject to take-or-pay the AT3 tariff is subject to take or pay – the impact of this shift of infrastructure cost recovery from a “non take-or-pay tariff to a take-or-pay tariff needs to be considered).

The inconsistency of the Electric Traction DAAU with cost reflective pricing principles is exacerbated by the fact that the proposed mechanism appears to be asymmetric. That is if electric traction utilisation falls and electric infrastructure costs are not recovered then this under recovery of the AT5 tariff is partially met by diesel users. If electric traction utilisation increases and electric infrastructure costs are over recovered via the AT5 tariff then the tariff adjustment from these over recoveries is to the AT5 tariff and so it only benefits electric traction users. Electric infrastructure cost under recovery is funded by diesel and electric users whereas electric infrastructure cost over recovery is returned to electricity users only via the AT5 tariff.

Pacific National’s concern is that any attempt to socialise electric infrastructure costs to diesel users ultimately results in a cross subsidy from diesel traction users to electric traction users. Such a cross subsidy is counter to the object of Part 5 of the QCA Act to promote the economically efficient use of the rail infrastructure.

- Impact on Electric Infrastructure Investment – the proposed Electric Traction DAAU allows Aurizon Network to further invest in electric infrastructure at a reduced risk as any under recovery will ultimately be recovered from diesel users. This provides an incentive for inefficient capital investment in the electric infrastructure which is counter to the object of Part 5 of the QCA Act to promote the economically efficient investment in rail infrastructure.

- Impact on Above Rail Competition – in line with previous Pacific National submissions on the issue of electric traction, Pacific National is concerned that Aurizon Network’s efforts to require diesel users to fund electric infrastructure ultimately acts to benefit Aurizon Operations – primarily in relation to the Blackwater system where Pacific National primarily operates diesel trains⁷ and Aurizon Operations primarily operates electric trains. Aurizon Network’s effort to shift electric infrastructure costs on to diesel trains, particularly in the Blackwater system, continues to raise concerns regarding the perception that in the Blackwater system the train operator which primarily operates electric traction is being favoured over the train operator which primarily operates diesel traction. The effect of the mechanism proposed is to favour one market participant over any other.

Aurizon Operations has a significant fleet of electric locomotives, including depreciated electric locomotives, and the Electric Traction DAAU proposal appears to benefit Aurizon Operations chosen operating mode given that it seemingly favours electric traction over diesel traction. The alignment of these interests is borne out by the fact that Aurizon Operations has recently publicly identified⁸ the sustainability of electric infrastructure tariffs as a concern and the arguments put forward by Aurizon Operations supporting the need for electric infrastructure tariffs to be reformed are consistent with the positions of Aurizon Network. Given the integrated nature of the Aurizon Group and the aligned interests of the separate business units of Aurizon Network and Aurizon Operations, Pacific National is conscious of the effect of the Electric Traction DAAU on the market in which Pacific National and other rail operators conduct business

Pacific National’s concern is that the potential of the Electric Revenue Adjustment to favour Aurizon Operations is counter to section 138 2) c) of the QCA Act and 168A c) of the QCA Act.

- Option Pricing Concerns – the Aurizon Network supporting submission⁹ claims that diesel users are considered to benefit from a free option to use electric infrastructure. Pacific National has numerous concerns with this Aurizon Network position:
 - Costless switching – the option pricing argument presented by Aurizon Network implies that train operators have the ability to switch between traction modes at

⁷ As outlined in this submission when Pacific National entered the market in 2009 it was required to operate a diesel trains in the Blackwater system. Aurizon Network then decided to invest in the Blackwater electric network at approximately the same time as Pacific National entered the market.

⁸ See Aurizon Operations Submission to Aurizon Network’s 2017 Draft Access Undertaking, February 2017, pages 5 - 10

⁹ See Aurizon Network, Submission 2017 Electric Traction Draft Amending Access Undertaking, November 2017, page 4

minimal cost. The QCA will be aware that this is far from the case, as locomotives are not only long term investments, they have significant lead times for delivery, so that switching cannot be done at a low cost in a short timeframe. In addition there are numerous other costs (such as the establishment of dedicated diesel provisioning facilities) which are specific to individual traction choices;

- Option pricing – the option pricing argument presented by Aurizon Network appears to be based on the cost of the option to Aurizon Network rather than the value of the option to the potential option user. Aurizon Network has not demonstrated that the Electricity Revenue Adjustment is equivalent to the option value. Pacific National believes that in theory the option pricing approach may be considered using an option pricing model. Pacific National understands that an option pricing model would take into account the trend and volatility of both diesel and electricity prices and the cost of converting from one form of traction to another. Pacific National does not believe that the approach proposed in the Electric Traction DAAU values the option via an option pricing model. The approach proposed in the Electric Traction DAAU prices the option based on an amount needed by Aurizon Network to recover the cost of infrastructure, and this amount is then levied on parties which do not use this infrastructure.
- Diesel Capacity Multiplier Charge – since at least 2009 there has been a capacity multiplier charge applied by Aurizon Network to diesel trains. This charge is currently applied as follows:
 - Goonyella System - 1.1 times the AT2 tariff; and
 - Blackwater System – 1.52 times the AT2 tariff.

Aurizon Network's argument for the capacity multiplier has been based on a position that diesel services are less efficient than electric services (applying 6.2.3 (c) (ii) of the current Access Undertaking). Pacific National has consistently opposed this Aurizon Network position¹⁰ and in Pacific National's view Aurizon Network has not been able to substantiate this claim with any strong evidence.

Given that the diesel capacity multiplier results in diesel traction services being levied with a higher access charge than electric traction then the further proposed Electric Revenue Adjustment charge act as a further deterrent to the operation of diesel traction by imposing additional costs on diesel traction unrelated to the infrastructure used by diesel traction

¹⁰ See for example Asciano Submission to the QCA on QR Network DAAU Electric Traction Services April 2012 page 16

services. Pacific National believes that at the very least if the Electric Revenue Adjustment charge is introduced then the capacity multiplier must be removed.

- Current Mechanism in Place to Address Electric Investment Recovery – the current Access Undertaking (UT4) includes a provision (Schedule F, 3.3 (n) of the current Access Undertaking) whereby any future electric enhancements or investments will be included in take or pay arrangements. That is, users that benefit from these electric enhancements will be subject to AT5 as a take or pay component based on contracted volumes in the relevant access agreement. Pacific National understands that this was included in the current Access Undertaking to address the concerns Aurizon Network had regarding the recovery of electric infrastructure investment. Pacific National believes this approach to recovery of investment by Aurizon Network in electric infrastructure is sufficient and appropriate and as such the current proposed Electric Traction DAAU mechanisms are not warranted.

Further to this matter Pacific National notes that Aurizon Network could have proposed similar take or pay arrangements for the AT5 tariff in its previous access undertakings but has chosen not to do so.

- Incentives for Innovation and Technological improvement – the Electric Traction DAAU will act as a disincentive for train operators to trial and adopt new forms of traction technology. The Electric Traction DAAU locks in electric traction as the preferred form of traction and operators adopting any new and more efficient form of non-electric traction technology will be required to subsidise the infrastructure required to operate a less efficient form of traction technology. Pacific National contends that the purpose of the regulatory regime is not to suppress innovation and efficiency in the operation of the regulated service. Pacific National believes that approving the proposed Electric Traction DAAU will impact innovation and efficiency.
- Aurizon Network Assumptions and Positions – Aurizon Network appear to have based the Electric Traction DAAU and the supporting submission on several assumptions and positions that may be questioned.
 - Appropriateness of Threshold Levels – the Electric Revenue Adjustment mechanism is based on electric usage thresholds of 98% in the Goonyella system and 75% in Blackwater system. Pacific National questions if a fall below these threshold levels genuinely impacts on the viability of the Aurizon Network electric infrastructure system. In particular Pacific National believes that a small reduction in the electricity usage in the Goonyella system below the 98% threshold would be

unlikely to materially impact cost recovery. If the aim of the Electric Traction DAAU is to prevent an increasing spiral of AT5 tariffs then the thresholds should be set at levels substantially lower than the current usage levels.

The issue of the threshold levels raises the question as to the ability of the Blackwater and Goonyella system to accommodate more electric locomotives. To this point Aurizon Network¹¹ state that “both Blackwater and Goonyella are approaching maximum possible utilisation of electrification assets”. Pacific National believes that Aurizon Network should clarify the ability of the Blackwater system in particular to accommodate more electric locomotives before acting to actively discourage the use of diesel traction.

Furthermore the Electric Revenue Adjustment electric usage thresholds outlined above are static. Given Aurizon Network’s concerns about an AT5 spiral it seems that ongoing year on year reductions in usage are of more concern than a “one-off” dip in usage levels. Pacific National believes that if the Electric Traction DAAU were to be implemented the threshold mechanism should be reconsidered as follows:

- the thresholds should be set at a lower level than is currently proposed to allow for yearly variations from the base year; and
 - the mechanism should be dynamic rather than static and only be triggered in the event of reductions over multiple years.
- o Diesel and Electric Price Relativities – the Aurizon Network concerns regarding electric infrastructure cost recovery appear to be partially based on the assumption that diesel prices will remain consistently lower than electricity prices. While Pacific National has no specific insight into the future energy price relativities Pacific National believes that the implicit assumption that diesel prices will remain lower than electricity prices should be supported with strong evidence.

The Aurizon Network concerns¹² are partially based on concerns regarding diesel and electric price comparisons, however these comparisons do not appear to have taken into account all of the costs associated with diesel traction. For example the additional costs of diesel traction can include costs of developing dedicated diesel provisioning facilities, costs of rail connections to these facilities, costs of increased

¹¹ Aurizon Network, Submission 2017 Electric Traction Draft Amending Access Undertaking, November 2017, page 23

¹² See for example Aurizon Network, Submission 2017 Electric Traction Draft Amending Access Undertaking, November 2017, page 12

environmental and safety compliance associated with diesel (for example diesel spill protection and emissions), costs of the additional time taken for provisioning (including labour costs) and locomotive maintenance costs. All of these costs should be considered in making traction choice decisions, and in some instances these costs would be major factors in determining traction choice. Pacific National believes that further clarity is needed as to what costs are included in Aurizon Network's analysis as it may be that the costs considered are not complete.

Pacific National believes that currently the choice between diesel and electric is driven by numerous factors including but not limited to current diesel and electric energy price relativities.

- Electric Utilisation Decreasing - the Aurizon Network concerns regarding electric infrastructure cost recovery appear to be at least partially based on a scenario where electric utilisation is decreasing. Based on Aurizon Network's supporting submission¹³ electric utilisation in the Blackwater system has been increasing steadily since 2010 (from below 40% to 75%) and electric utilisation in the Goonyella system has been flat at close to 100% since at least 2004. Further to this as indicated in Section 2 of this submission Pacific National is increasing electric traction operations in the Blackwater system. Pacific National believes that the implicit assumption that electric utilisation rates are expected to decrease in the future must be supported with robust evidence for users to consider that this proposition has any merit. Recent experience supports a steady increase in electricity utilisation rates in the Blackwater system in particular.
- Other matters – Pacific National believes that if the Electric Traction DAAU were to be approved the following practical matters would need to be addressed in the final iteration:
 - Exemption for services that can only operate as diesel traction – As the QCA will be aware there are some services where only diesel trains can be operated. This may be as a result of a lack of electric infrastructure at mine sites, spur lines or adjoining networks. Train services using sections of track which do not have electric infrastructure should be exempted from paying any Electric Revenue Adjustment.

¹³ Aurizon Network, Submission 2017 Electric Traction Draft Amending Access Undertaking, November 2017, page 11

In addition there are also services that require diesel trains due to operational constraints such as the service requiring push/pull configuration. Such services should be exempt from paying any Electric Revenue Adjustment.

- Exemption for damaged electric infrastructure – There are instances where electric infrastructure is damaged (for example during storms and cyclones) but the track infrastructure is undamaged. In these circumstances diesel trains are able to operate whereas electric trains cannot operate. Any circumstances such as this the operation of diesel traction services should be exempted from the Electric Revenue Adjustment calculations.

6. Pacific National's Possible Alternative Approaches to Electric Traction Issues

Pacific National continues to strongly support the principle that users of the Aurizon Network infrastructure should have freedom of traction choice and should only be charged for the infrastructure that they actually use in operating train services. As noted above Pacific National supports the current Access Undertaking (UT4) provision (Schedule F, 3.3 (n) of the current Access Undertaking) whereby any electric enhancements or investments going forward will be included in take or pay arrangements for this reason.

If the QCA determines that changes to AT5 tariffs and other tariffs are ultimately considered to be necessary to address Aurizon Network concerns regarding electric traction, then Pacific National believes that those changes to the access pricing structure should be both forward looking and avoid impacting current commercial arrangements for the operation of services on the Aurizon Network rail infrastructure. Further changes to AT5 tariffs and other tariffs require that the current mechanism for the diesel multiplier must be removed.

Pacific National suggest that there are several forward looking options that could be considered as alternative mechanisms to those proposed in the Electric Traction DAAU . These include:

- Switching Fees – switching fees could be applied to any operator or end user that switches from electric traction to diesel traction in the future. While this restricts future traction choice it has the benefit of being forward looking, being within the control of the train operator, protecting sunk investments in diesel locomotives and addressing some of the Aurizon Network concerns regarding increased diesel traction usage.

There is a precedent for such fees. For example the ACCC¹⁴ has allowed a similar fee for irrigation infrastructure users who cease using the irrigation infrastructure.

This switching fee approach would substantially reduce the risk that increasing diesel traction use would lead to the under recovery of electric infrastructure costs, while at the same time ensuring that current diesel traction users are not cross subsidising electric traction users.

- Amending the depreciation profile – this approach is used in other regulated industries and allows depreciation to be back ended. This provides for reducing prices of electric infrastructure now and then recovering the depreciation in later years as the capital base has reduced. Pacific National appreciate that while such an approach is used in other forms of regulated infrastructure applying this approach to Aurizon Network's electric infrastructure may be problematic given that the electricity infrastructure assets are already through a substantial portion of their life cycle and any changes to their depreciation profiles may impact current commercial arrangements.
- Grandfathering – In any event Pacific National believes that grandfathering of current diesel locomotives (for example the Pacific National 83 class) from the proposed Electric Traction DAAU is necessary. Such an approach would address concerns relating to regulatory uncertainty and assist in ensuring that investments made under a given regulatory regime are not jeopardised by changes to that regime.

For example this grandfathering would protect current diesel operations from having to pay the Electric Revenue Adjustment in the event that a new entrant entered the market with diesel locomotives thus triggering the thresholds of the Electric Revenue Adjustment.

7. Electric Traction DAAU in the Context of the Regulatory Regime

The Queensland rail access regime is largely governed by the QCA Act. In particular sections 138, 143 and 168A of the QCA Act require the QCA to consider various factors when assessing the DAAU pricing proposal.

The object of Part 5 (sections 138 and 143) of the QCA Act is to promote the economically efficient operation of, use of and investment in, infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets. Section 168A of the QCA

¹⁴ See ACCC Water Charge Termination Fees Rules Final Advice December 2008

Act requires that pricing for a service should generate expected revenue for the service that is at least enough to meet the efficient cost of providing access to the service.

Pacific National makes the following comments in relation to the requirements of the QCA Act relevant to the issues at hand. Some of these comments are expanded upon above within the body of this submission.

Table 2: Comparison of Electric Traction DAAU Proposal with QCA Act Requirements

Requirement of the Act	Pacific National Comment on the Inadequacy of the DAAU in relation to QCA Act Requirements
<p>s138 – Consider the object of Part 5 of the QCA Act 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.</p>	<p>The DAAU does not encourage efficient operation of, use of or investment in below rail assets. The proposed pricing is not cost reflective and has the potential to create cross subsidies.</p> <p>The DAAU does not promote dynamic efficiency as it removes incentives for prudent and efficient investment, including investment in new technology.</p> <p>The DAAU does not promote effective competition in upstream or downstream markets as given the locomotive fleets active on the Aurizon Network:</p> <ul style="list-style-type: none"> • it may favour Aurizon Operations; • it may disadvantage Pacific National; <p>Thus it distorts in competition in the above rail market and has the effect of damaging competition in that market.</p>
<p>s138 - Consider the legitimate business interests of Aurizon Network.</p>	<p>Pacific National submits that the DAAU does not reflect the legitimate business interests of Aurizon Network. Rather, the DAAU seeks to create an environment which favours Aurizon Operations to the disadvantage of Aurizon Operation's competitor, Pacific National.</p>
<p>s138 - Consider the public interest, including the public interest in having competition in markets (whether or not in Australia).</p>	<p>The DAAU does not promote the public interest in competition as it favours one rail operator over another.</p>
<p>s138 - Consider the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected.</p>	<p>The DAAU does not promote the interests of access seekers as it leads to pricing uncertainty.</p> <p>Further, Pacific National has invested in capital assets which may be adversely impacted by the DAAU.</p>

Requirement of the Act	Pacific National Comment on the Inadequacy of the DAAU in relation to QCA Act Requirements
s168A - Pricing principles – price of access to a service should achieve generate expected revenue for the service sufficient to meet the efficient cost of providing access to the service and include a return on investment.	The DAAU results in a cross subsidy from diesel users to electric users.
s168A -Pricing principles – price of access to a service should not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent that the cost of providing access to the other operators is higher.	The DAAU effectively establishes pricing processes which have the potential to favour Aurizon Operations over Pacific National, even though the cost of providing access to both operators is similar.
s168A -Pricing principles – price of access to a service should provide incentives to reduce costs or otherwise improve productivity.	The DAAU does not provide any incentives to reduce costs and may: <ul style="list-style-type: none"> • provide incentives for over investment in electric infrastructure; and • provide disincentives to invest in new traction technologies (which may improve productivity).

8. Conclusion

In summary Pacific National has concerns about the application of the proposed Electric Traction DAAU and in particular the proposed Electric Revenue Adjustment. These include:

- inconsistency of the proposal with cost reflective pricing principles;
- the potential for the proposal to impact on above rail competition between Pacific National and Aurizon’s above rail operations;

Aurizon Network is also seeking to introduce a Variable Connection Charge. Pacific National has no fundamental concern with this re-alignment of costs between tariffs provided that it is executed in a transparent manner and the actual charges reflect costs incurred.

Pacific National submits that when taking into account the factors set out in the QCA Act, the QCA cannot approve the current Electric Traction DAAU as Electric Revenue Adjustment fails to properly meet the relevant objectives and pricing principles of the Act.