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Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Email: rail@qca.org.au

Short term transfer mechanism – Request for further information

The Queensland Resources Council (QRC) appreciates the opportunity to provide additional information regarding Aurizon Network's proposed short term transfer ("STT") mechanism, as requested in the QCA's Stakeholder Notice of 16 September 2015.

Background:

The QRC generally supported the STT mechanism proposed by Aurizon Network. The QCA's Supplementary Draft Decision proposed that the mechanism should be amended in a number of ways. The key changes proposed by the QCA were:

- To require that the transferee pays the greater of the Access Charge which would have applied had the transferor used the paths, and the charge calculated based on the transferee's haul distance. We understand that this was intended to prevent a loss of revenue to the system when a transferee has a shorter haul distance. Such a loss of revenue, under the revenue cap arrangements, could have adverse impacts on other users.
- As a result of the QCA's proposed pricing mechanism, which would eliminate any risks of 'gaming' behaviour (such as transferring paths to a shorter haul, with no genuine intention of using the transferred paths, in order to reduce Take or Pay liabilities), the QCA proposed to remove a range of gaming protections which were proposed by Aurizon Network.

In June 2015, QRC provided a submission on the Supplementary Draft Decision. The QRC's key points were:

- An analysis of the risks to system revenue arising from a transfer of paths to a shorter haul reveals that a material loss of revenue is unlikely. Rather, in most cases, an increase in revenue is likely. This is because:
 - Any loss of revenue relates to the AT3 and AT5 tariff components only. The AT2 and AT4 components do not vary with distance (and therefore there is no loss of revenue), while the AT1 and EC components reflect a variable cost (and therefore will not create a shortfall which impacts on other users).

- The loss of revenue only arises if it is assumed that the path, if retained by the transferor, would have been used. This is unlikely.
- If it is assumed that the path, if retained by the transferor, would not have been used, but will be used by the transferee, then an increase in revenue is likely to result from the transfer. This is due to the nature of Take or Pay arrangements.
- While the QCA's proposed pricing mechanism would be very effective in protecting other users from the risk of revenue loss from STT's, the benefits of this protection must be weighed against the additional complexity of the arrangement. On balance, QRC prefers to trial a simpler approach for the term of UT4, noting that increased protections could be implemented for UT5 if revenue loss was found to be significant.

Further consultation:

A meeting involving the QCA, Aurizon Network and the QRC was held on the 26th of June. The discussion focussed on the extent to which a higher access charge under the QCA's proposal would dis-incentivise transfers. This is discussed further in our response to Question 1.

QCA request for further information: Responses:

Question 1: Please provide examples of previous transfers or hypothetical examples of transfers that you would not undertake if the transfer was subject to the pricing mechanism outlined in decision 4.1 of our Draft Decision.

Our understanding of the QCA's proposed pricing mechanism is that, in the case of a transfer to a shorter haul, the tariff components which vary with distance would be calculated by reference to the haul distance of the transferor. This would include AT1, AT3, AT5 and EC. Our first point on this proposal is that we see no need to apply this rule in regard to AT1 and EC. A loss of revenue on these items has no impact on other users of the system under the revenue cap arrangements. We suggest that if the QCA retains its proposed pricing mechanism, that the 'greater of' rule should apply to AT3 and AT5 only.

Assuming that the QCA's pricing mechanism is applied only to AT3 and AT5, the following are examples of the 'premiums' which would be payable by the transferee (compared to their normal access charge):

- For a 170km Goonyella haul, transferred from a 270km haul: 84c/t.
- For a 300km Blackwater haul, transferred from a 350km haul: 55c/t.

Whether these premiums would cause a potential transferee to withdraw from a proposed transfer will depend on the particular circumstances:

- If a transfer is sought in order to produce and rail incremental tonnage from a mine, then the margin on the incremental tonnage would need to be greater than the premium in order for the transaction to add value. Amounts such as those above would often not be material in these cases, however, in the current market, margins are low and the risk of these additional costs creating a meaningful disincentive is higher.
- If short term transfers are being used to address short term peaks and troughs in a

customer's railings, then the premium is more likely to create a disincentive. Without the premium, the customer may at times act as a transferee, and at times be a transferor. If the net total transfer is zero, then (absent the premium) the customer will rail the same tonnage, will face the normal access charge, but will enjoy greater flexibility, while the utilisation of rail capacity will be more efficient. However, faced with the premium, flexible use of capacity will increase the average access charge of the customer, even if the net transfers in/out over time total zero. Therefore, the customer may elect to forego the opportunity to arrange transfers, and capacity is likely to be used less efficiently. An example of the type of arrangement which may be negatively impacted by the QCA's pricing proposal is where a party seeks to 'borrow' capacity in a certain scheduling period, having agreed to repay the transferor (in capacity) in a later period. While it is acknowledged that operators can achieve an effective transfer of paths within a portfolio by diverting scheduled trains, this method of achieving STTs does not promote efficient planning and scheduling, and is also unable to be used across different operators.

Question 2: Please provide examples of 'gaming' behaviour that may occur.

The concern regarding 'gaming' behaviour was the risk that excess contracted capacity could be transferred to a shorter haul mine with the transferee having no intention of using the transferred paths. That is, a transfer could be arranged simply to reduce the Access Charge on which ToP calculations are based.

For the reasons discussed in the introductory section, we do not have concerns with 'gaming' behaviour in the case where the transferred paths are used.

Question 3: Please provide any comments on whether Aurizon Network's proposed 85% requirement will identify and stop any 'gaming' behaviour identified in your response to question 2.

Our concerns about gaming behaviour are mitigated by the fact that the opportunity to reduce ToP through transfers arises in regard to AT3 only. This is because AT1, AT5 and EC are not subject to ToP, while AT2 and AT4 are not distance related. The reduction in AT3 on the transfers discussed under Question 1 (which are very substantial transfers in terms of distance) is around 30c/t. This is the loss of ToP revenue assuming that ToP triggers and is not capped. Therefore the risk of loss of revenue due to gaming is not significant in regard to short term transfers.

On this basis, we are comfortable, for an initial trial period, with a general test relating to whether the transferee has a genuine intention of using the transferred paths. Aurizon Network proposed (clause 7.5.3(b)(v)) that it would have the right to refuse a transfer if "*Aurizon Network is not satisfied, acting reasonably, that the proposed Short Term Transferee for the proposed Short Term Transfer has a genuine intention or ability to utilise the Short Term Access Rights*". We are comfortable with this general test for the remaining term of UT4, noting that this period is likely to be quite short following approval.

Regarding clause 7.5.3(c)(i) and (ii), we consider that rejecting a transfer purely on the basis of either of these tests, without considering other relevant information, would not be reasonable. System performance issues, impacts of weather, above rail issues, short term issues at a mine or a range of other factors may have prevented a past transfer from being utilised at the 85% level, and may not indicate a lack of a genuine intention or ability to use a future transfer. Part

(ii), which requires that a potential transferee fully utilises all of its existing access rights for the prior three month period, is particularly onerous and is likely to be satisfied by very few customers.

We consider that these tests are unnecessary as Aurizon Network should rely on the general test in clause 7.5.3(b)(v). In considering that test, it would be reasonable for Aurizon Network to take into account the past performance of the transferee, including in regard to utilisation of past transfers, however, these considerations alone would not be deemed to determine the outcome of Aurizon Network's "reasonable" assessment.

Question 4: Please provide comments on alternatives to Aurizon Network's proposal that you consider more appropriate.

We remain comfortable with the general test under Clause 7.5.3(b)(v), but suggest the deletion of clause 7.5.3(c). Alternatively, if tests such as these were to be retained, we would suggest that they be reversed, such that, for example, the utilisation by the proposed transferee of more than 85% of its contracted paths in previous periods could create a presumption that there is a genuine intention to use the transferred paths, and Aurizon Network would then only form a 'reasonable opinion' to the contrary based on strong evidence (such as the inability of the loading facility to accommodate the transferred volume).

A further alternative option to address gaming risks would be the partial implementation of the QCA's pricing mechanism, in the form of a requirement that, where ToP is payable by a transferee, the ToP be calculated based on the Access Charges of the transferor (i.e. apply the transferor's distance to AT3).

This option would address the risk of excess capacity being transferred to a transferee with no intention of using the paths, in order to reduce ToP. However, we understand that this approach would be difficult to implement, and we do not consider that the complexity is justified, given the materiality of the risk. We prefer a simpler approach for the term of UT4 and suggest that pricing solutions be considered for UT5 only if a material loss of revenue is found to occur through STTs during the remaining term of UT4.

Question 5: Please provide any comments on whether the requirement to demonstrate ability to load a train will identify and stop any 'gaming' behaviour identified in your response to question 2.

We do not consider that this requirement is necessary in order to stop gaming behaviour. The general test in clause 7.5.3(b)(v), or the alternative discussed under Question 4, is likely to be sufficient. However, we understand that there is also little point in allowing transfers to occur if the transferee has no ability to use the capacity transferred. We therefore have no objection to Aurizon Network's proposed requirement regarding capacity of loading facilities, provided that the capacities of each facility are agreed or determined, and documented, so that the constraints are understood and do not lead to unexpected rejection of proposed transfers.

Question 6: Please provide comments on alternatives to Aurizon Network's proposal that you consider more appropriate.

N/A.

Question 7: Aurizon Network's proposed mechanism limits short-term transfers to:

- 25% of the TSEs in an access holder's access agreement(s) for the relevant origin to destination train service in any one financial year
- coal traffic only, and
- services that have charges based on the same reference tariff.

Please provide comments on alternatives to Aurizon Network's proposal that you consider more appropriate.

25% limit:

Our understanding of the 25% limit is that Aurizon Network requires an opportunity to assess impacts on the system of transfers beyond this level. For larger transfers, the long term transfer arrangements remain available. We consider this a workable approach for the initial implementation of the STT mechanism.

Non-coal:

Extending the short term transfer mechanism to non-coal traffic would create pricing issues which QRC has not considered in detail.

For a transfer from coal to non-coal, the potential loss of revenue could be significant and would need to be addressed, and the revenue earned from the non-coal traffic would need to be included in actual revenue for the purposes of the revenue cap adjustments (or the MAR reduced).

A transfer from non-coal to coal appears less problematic, however, allocation of the revenue would need to be considered, and the MAR may require adjustment.

At this stage, QRC is comfortable with the proposal to limit the mechanism to coal services.

Same reference tariff:

Ideally, the STT mechanism would extend to all transfers within the same system, without being limited to situations in which both parties pay the same reference tariffs. However, this flexibility does raise a number of additional pricing issues:

- The allocation of revenue received from the transferee between reference tariff groups would need to be considered. Allocating the revenue to the transferor's pricing group may be the most equitable option.
- In the case where the transferor is paying substantially higher reference tariffs than the transferee, the loss of revenue may be substantial. Unlike the situation in which both parties are paying the same reference tariffs, (where a loss of revenue occurs only in regard to transfers to a shorter haul and then relates to AT3 and AT5 only), if parties are paying different reference tariffs, a loss of revenue could relate to all tariff components, and could occur even on a transfer to a longer haul. Implementation of the QCA's "higher of" pricing

approach in regard to cases where the transferor is paying a higher reference tariff may address the issue.

For the initial implementation of the STT mechanism, QRC was comfortable with the proposed restriction of STT's to parties paying the same reference tariffs; however, we would welcome the extension of the mechanism as discussed above.

Question 8: A number of stakeholders submitted that the definition of a "common destination" is unclear. Please provide comments on the appropriate definition of common destination.

For the initial implementation of the STT mechanism, QRC was comfortable with the proposed restriction of STT's to parties having a common destination, which we understood to mean the same unloading point (coal terminal or end customer facility) but not different coal terminals at the same port. However, we would welcome the removal of this restriction. To do this, the transferee's demand for additional infrastructure, and the availability of that infrastructure, would need to be considered. We see this as being very similar to the issue of "ancillary access rights", and suggest that the existing drafting proposed by Aurizon Network in regard to ancillary access rights could be readily applied to additional Access Rights required by the transferee at the destination end of the haul.

Thank you again for the chance to provide comments. The QRC contact on this submission is Andrew Barger, who can be contacted on 3316 2502 or alternatively via email at andrewb@qrc.org.au

Yours sincerely



Michael Roche
Chief Executive