



3 October 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
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Dear Malcolm,

Aurizon Network's 2014 Draft Access Undertaking

BHP Billiton Mitsubishi Alliance (BMA) welcomes the opportunity to comment on Aurizon Network's 2014 resubmitted Draft Access Undertaking (DAU). BMA supports the Queensland Resources Council (QRC) submission in response to Aurizon Network's August 2014 DAU.

BMA has worked collaboratively with the QRC, as part of the QRC's 2014 DAU steering committee and working group. We request you to consider the latest QRC's response submission (October 2014), QRC's previous submissions to 2013 DAU (October 2013 and January 2014) and our previous 2013 DAU submission together as comprising BMA's full response on issues arising from Aurizon Network's 2014 DAU.

BMA provided detailed comments on all aspects of Aurizon Network's 2013 DAU in the October 2013 and January 2014 consultation process. Without restating in detail all the concerns raised in the above mentioned submissions, BMA will like to take this opportunity to highlight the following issues as comments and to emphasise the significance of these issues to us. We therefore recommend that the QCA takes into account the recommendations and drafting suggestions provided by the QRC in approving Aurizon Network's 2014 DAU in ensuring:

- that the approved reference tariffs are based on efficient and transparent costs;
- there is an adequate balance between Aurizon Network's commercial return and risk profile;
- stronger conflict of interest arrangements including non-discrimination provisions exist in the approved undertaking;
- reduced commercial uncertainty and limiting Aurizon Network's ability to pass on unreasonable commercial risks to end users.

Cost Competitiveness

BMA appreciates the collaborative approach of Aurizon Network in working with the QRC and its willingness to include suggestions put forward by the coal industry resulting in a resubmission of the 2014 DAU that is close to the agreed industry position on most commercial terms. That said, the resubmitted 2014 DAU does not address pricing or tariff aspects of providing access to below rail infrastructure. Even though Aurizon Network has significantly addressed industry concerns on the commercial terms it has not made any adjustments to its tariff expectations. Accordingly, BMA would like to reiterate the importance of price certainty and cost efficiency when approving the pricing components of the proposed 2014 DAU.

One of the critical issues faced by the coal producers in Queensland is the continued fall in global coal prices coupled with the fall in the competitive position of the Queensland resources sector. Improving the global competitiveness of the Queensland coal sector by ensuring that costs of accessing below rail infrastructure are efficient and transparent is of paramount importance. The

Queensland coal sector has made substantial progress reducing its controllable costs. In contrast, Aurizon Network's excessive reliance in its 2014 DAU on commercial negotiations and non-standard terms and conditions to extract a price premium from end users is unacceptable.

While BMA has over the past year undertaken measures to cut mining costs and improve productivity to survive the coal market conditions, Aurizon Network has made no apparent efforts to constrain overall costs over the term of the 2014 DAU. In fact, there is a significant increase in the below rail cost of providing services, including expansions with efforts to pass on commercial risks to end customers. This has direct implication on the cost competitiveness of BMA's business. Therefore, in approving the 2014 DAU, the QCA should ensure that the Queensland coal industry remains competitive and that Aurizon Network is not allowed to extract monopoly returns.

Pricing Principles

As noted in our earlier submission, BMA supports the fundamental principle that existing customers should not bear any of the commercial risks and costs associated with major expansions of the network that, if included in the existing pricing of the coal system, would result in the reference tariff increasing for all existing customers. Non-expanding customers should not have to bear any additional costs if they:

- do not receive any significant financial or operational benefit by way of increased system throughput; and
- are not involved in the negotiation of the expansion project.

Further, non-expanding customers should not bear any default or asset stranding risk of an expansion project commercially negotiated between Aurizon Network and expanding users.

BMA supports the QRC's position on pricing on capacity expansion and reiterate that Aurizon Network should not be allowed to socialise risks arising from an expansion project (irrespective of the funding source) with existing users either directly through its pricing principles or indirectly through changes to the pricing limits or the capital expenditure approval process for expansions or duplications.

Wiggins Island Rail Project Pricing Treatment

As an existing Blackwater system customer BMA is concerned that there should not be any socialisation of Wiggins Island Rail Project (WIRP) costs within the existing Blackwater and Moura asset bases where this would have the effect of passing on Aurizon Network's asset stranding, credit or volume risks to existing customers. This is of particular concern where Aurizon Network has apparently extracted additional returns on WIRP from Wiggins Island Coal Terminal (WICET) foundation customers.

Aurizon Network has claimed that the Blackwater duplications were previously endorsed by existing Blackwater system customers through the 2008 Coal Rail Infrastructure Master Plan (CRIMP) process. However BMA notes that Aurizon Network has subsequently demonstrated that these duplications were not required in the absence of WICET expansion. BMA accordingly is opposed to the socialisation of the related duplication capital expenditure in the existing Blackwater asset base.

Price limits for stand-alone tariffs settings

BMA does not support Aurizon Network's proposal of aligning the price ceiling limits or the maximum allowable revenue for individual or a combination of train services by utilising the Depreciated Optimised Replacement Value (DORC) rather than the relevant Regulated Asset Base (RAB).

While this will not impact the maximum allowable revenue earned by Aurizon Network it will definitely reduce the risk profile of Aurizon by transferring any asset stranding risk on to existing users while earning an above regulated rate of return on investments. Further, this approach has the potential to be unfair while adding uncertainty to commercial position of exiting users as it will be applicable to only some services. BMA believes that Aurizon Network's proposed approach introduces inequity and inefficiency by forcing existing users to pay for the infrastructure costs of expanding users especially when there is no guarantee that the new created capacity will be utilised to capacity.

Allocation of capital expenditure

There is no clear process in UT3 or UT4 regarding capital expenditure allocation between systems and expanding and non- expanding users which forms the basis of reference tariffs. The Goonyella to

Abbot Point Expansion (GAPE) and WICET projects clearly demonstrate the need for the 2014 DAU to have a clear framework for pricing future expansions and the allocation of capital expenditure.

BMA believes that there should be complete transparency in the allocation of project costs and the corresponding economic benefits arising as a result of any expansion between expanding and non-expanding users or between systems. This will provide transparency and enhance confidence in the regulatory process by ensuring that producers are not cross subsidising other users and systems.

Standard Access Agreements

BMA is generally supportive of the proposal of simplification of the different forms of standard access agreements to avoid duplication where possible. BMA supports the end user form of access agreement where the end customer is able to hold capacity by executing an agreement with Aurizon Network and then negotiate with competing operators to utilise these rights.

That said, BMA believes that the QCA should retain the ability for train operators to seek and hold capacity on behalf of the end customer provided that the operators can clearly establish their bona fides as an access seeker. This will avoid Aurizon Network having to engage in negotiations with operators that have little prospect of using the rights they are seeking.

BMA supports the amendments recommended by the QRC to UT4 standard access agreements. However, some of the concerns that BMA has regarding Aurizon Network's proposal are as follows:

- Price differentiation - the proposed standard access agreements allow Aurizon Network to further price differentiate train services based on the non-standard commercial terms and conditions under access agreements.
- Flexibility - Short term capacity transfers provide flexibility in the allocation of capacity promoting efficient use of infrastructure. BMA supports Aurizon Network's initiative to maximise the system throughput by better managing its short term variability in production. The QCA in approving any short term transfer provisions must ensure that the provisions are sufficiently flexible and that there are no superficial restrictions that prevent maximum utilisation of existing rail infrastructure.
- Ensuring an appropriate commercial balance between Aurizon Network and access seekers with respect to risk and obligations.

Conflict of Interest and Ring fencing

BMA considers the significant watering down of the ring fencing obligations in the proposed 2014 DAU is inappropriate. Instead BMA believes the existing provisions under Part 3 of the 2013 access undertaking should be extended to include not just ring fencing but conflict of interest obligations to provide protections against the increasingly integrated nature of Aurizon Network (and related Aurizon group) operations and its interests in future infrastructure assets such as ports, mining operations and other rail infrastructure besides the Central Queensland Coal Network (CQCN).

Accordingly BMA endorses QRC's submission and proposed drafting on this matter and reiterates the following concerns:

- broadening of the ring fencing provisions under Part 3 of the 2013 Access Undertaking so as to include non-discrimination, conflict protections and confidential information;
- the potential for Aurizon Network to hold an expanded role in supply chain coordination would mean that Part 3 should include additional protections regarding conflict of interest and discrimination; and
- provision of below rail regulated services by Aurizon Network related entities or joint ventures could potentially give rise to anti-competitive behaviour.

Given that Aurizon Network has resisted any further negotiations with the industry on this matter it is important the QCA ensures that there are adequate protections in place against any anti-competitive or discriminatory behaviour by a vertically integrated monopoly service provider.

System Rules

As part of the QCA's consultation process, BMA provided a detailed and considered response to Aurizon Network's submission on draft system rules on Northern Bowen Basin. However, BMA is disappointed that there has been no feedback regarding its submission that Aurizon Network should ensure transparency of Train Service Entitlement (TSE) consumption or TSE determination. TSE

utilisation is the primary mechanisms by which productive use of the network capacity is monitored, haulers are held to account for performance and gaming is discouraged.

Further, TSE determination must appropriately consider the impact of capital programs and maintenance activity on capacity. BMA's previous submission proposed that the calculation of monthly and weekly TSEs in an access agreement needs to consider a reduction in the days available for running trains commensurate with the impact of such activity on the network. This has not been addressed by either the consultant's report or by the Aurizon Network's response.

BMA is not clear on how Aurizon Network treats TSE consumption. TSE Consumption should be limited to two if a train service that has been published in the 48 hour plan is diverted but is still run within the 48 hour environment without adversely affecting another access holder's contractual rights. If a train service can be successfully diverted in the 48 hour plan, the access holder should not be penalised by deeming that four TSEs have been consumed. This approach would benefit the entire system as it would encourage access holders to advise of changes within the 48 hour period to optimise the potential for another party to use those paths.

Other

Further BMA strongly opposes the present approach where industry effectively underwrites Aurizon Network's cost of defending its commercial interests in preparing these undertakings. The costs that Aurizon Network can include in its RAB and be compensated for should be limited to the efficient costs of providing access to below rail services and only include a return on investment commensurate with the regulatory and commercial risks of providing access.

In essence the 2014 DAU should safeguard against monopoly rents and cost inefficiencies while providing price certainty and fairness of access to users of the CQCN.

This submission identifies only the key issues and concerns BMA has in relation to Aurizon Network's 2014 DAU, and should not be regarded as exhaustive on all issues. Given that there is an ongoing dialogue between users and Aurizon Network, BMA would appreciate the opportunity to provide further comments on the 2014 DAU and other matters that may arise during the development of the Draft Decision.

If you have any queries or require further information, please feel free to contact Alistair Baben der Erde at 07 3329 2507 or Ruchi Gupta on 07 3329 2348.

Yours sincerely

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