

SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY

AURIZON NETWORK'S PROPOSED SHORT TERM TRANSFER MECHANISM

FEBRUARY 2015

1. Executive summary

Anglo American Coal Australia (**Anglo American**) welcomes the opportunity to make submissions to the Queensland Competition Authority (**QCA**) in relation to Aurizon Network Pty Ltd's (**Aurizon Network**) proposed short term transfer mechanism for inclusion in the 2014 Draft Access Undertaking (**UT4.2**).

Anglo American has previously noted that a short term rail capacity transfer mechanism is required in order to assist coal providers, and more generally the coal export supply chain, to overcome "day of operations" and other system losses as well the natural variations in mining production and export in order to maximise throughput.¹ It is also important in offsetting the effect of "overs" and "unders" which occur from month to month due to track access being allocated monthly (effectively on a "use it or lose it" basis each month) while port capacity is contracted as an annual entitlement.

A short term transfer mechanism will allow users to transfer rail capacity quickly and simply in months where they will not use their contracted entitlement or take a transfer of rail capacity in months where forecast production is higher than monthly entitlement if excess capacity is not being used by others in order to ensure the most efficient use of access rights across the entire supply chain. Importantly, this is critical for users that have export capacity through cargo assembly terminals (such as Dalrymple Bay Coal Terminal (**DBCT**)) which by the nature of the supply chain are required to peak railings in short periods of time to build cargoes based on vessel turn of arrival. Where producers are required to peak rail at slightly different periods in a month, the introduction of a short term capacity transfer mechanism would be an important step toward increasing the overall network throughput (and, therefore, productivity and allocative efficiency) by allowing each producer to have access to additional paths when required to meet peaking requirements if the other is not using its allocation at that time and vice versa.

Anglo American submits, however, that the introduction of a short term capacity transfer mechanism must be done carefully, acknowledging the impact that the mechanism could have on the competitiveness of other aspects of the supply chain, including the possibility that the mechanism could be used by Aurizon Network, train operators or even coal producers to commercially "game" the use of the coal export chain. It is also important to ensure the risk of creating a secondary market, where access holders can be opportunistic, is avoided.

Because of the possibility for gaming, Anglo American believes that it is essential that the system is clear and transparent. This includes the central provisions being contained in the

¹ Anglo American, *Submission to the Queensland Competition Authority: Aurizon Network's 2014 Draft Access Undertaking (UT4.2)* (3 October 2014) 42-43.

relevant Access Undertaking, rather than being included in individual user's Access Agreements, which are subject to confidentially negotiated amendments so that users will not be able to determine whether the transferee has the same capacity trading provisions as the transferor and may even be prohibited by the Access Agreement from sharing this information in a commercial negotiation for the transfer of capacity.

Anglo American notes that Aurizon Network has redrafted its short term capacity transfer mechanism proposal so that the provisions are contained in the Access Undertaking, rather than in the Standard Access Agreements (SAA). Anglo American submits that this is the only workable proposal. However, Anglo American does remain concerned with some aspects of the proposal put forward by Aurizon Network, as set out below.

2. Restrictive nature of the proposal

In light of the desirability of short term transfers, Anglo American's main concern with Aurizon Network's current iteration of the short term transfer mechanism proposal is that it is too restrictive to operate as an effective capacity transfer scheme.

While Anglo American has dealt with this in more detail below in relation to specific concepts, it believes that:

- (a) it is too restrictive to only allow short term transfers between contracts with exactly the same Reference Tariff as appears to be the case. Anglo American believes that, while other users should not be disadvantaged or impacted by a short term transfer, there should be scope to broaden the application of the short term transfer mechanism to ensure that as much capacity as possible can be transferred to increase the total usage of network capacity and subsequently increase its overall efficiency and throughput;
- (b) there is a significant degree of uncertainty in the Proposal as to the length of a transfer and the requirement that the transfer be lodged "no more than 7 business days" prior to the close of train orders is too restrictive. Anglo American foresees that the most successful use of the short term capacity transfer mechanism will be where capacity is for the transferee to expand its usage for production peaks or shipment output over a several week period in excess of its monthly allocation on a weekly basis. As such, Anglo American believes that the short term capacity transfer mechanism should reflect transferees' and transferors' rights to transfer the required capacity for multiple week periods to allow for the maximum use of that for peak raiing or peaking production periods, again working to improve the overall throughput and efficiency of the Central Queensland Coal Network (CQC�) as a whole; and

- (c) all aspects of the short term transfer mechanism seem to relate back to fixed weekly train ordering processes and the development of the ITP. Anglo American has raised concerns regarding the ITP and scheduling processes in a number of its submissions to the QCA, and continues to question the basis for the current weekly fixed scheduling process as being beneficial to the supply chain. Anglo American believes that the short term transfer mechanism should not be so integrally related to the Aurizon Network weekly scheduling process, or else it should only be done so after the QCA has made a final determination on this issue in its UT4 Final Decision. Otherwise the operation of the short term transfer mechanism could be flawed due to an unapproved or inflexible scheduling mechanism, thus reducing the effectiveness of the short term trading mechanism and also reducing its efficiency benefits.

Because of these reasons, Anglo American believes that the entire short term transfer mechanism needs to be reviewed to improve its flexibility and broaden its scope, otherwise it will have limited application and not be able to achieve the efficiency objectives that it originally planned to deliver.

3. Requirement for a common destination

Anglo American notes that Aurizon Network has suggested a number of requirements to restrict the short term transfer of capacity, including that the short term transfer:

- (a) utilises the same route (including common rail infrastructure); and
- (b) has a common destination.

Anglo American believes that the concept of "common destination" requires greater definition.

Reviewing Aurizon Network's explanation of a "common destination", Anglo American understands that Aurizon Network intends this to mean that the transferee must have the exact same port destination as the transferor's access rights. Anglo American believes that a common destination should include another terminal in the same port as the original train path (to a reasonable extent) provided the transfer does not have a detrimental impact on existing users.

As currently drafted, Anglo American sees situations arising where mines are unable to transfer capacity (even though the short term mechanism might exist) because there is simply no transferee available without access to an alternate terminal. Anglo American believes that this means that the short term capacity transfer mechanism will not be achieving the goals that it was originally envisaged to deliver.

4. Capacity assessment and capacity assessment criteria

Anglo American understands that for any short term capacity transfer Aurizon Network will be required to determine whether there is sufficient capacity available to complete the transfer.

As it has submitted before, Anglo American does not agree with Aurizon Network's approach to the lack of transparency of available capacity and baseline capacity in relation to the CQCN. Without further information on the baseline capacity of a particular system, as well as up to date information on the actual available capacity for that system, only Aurizon Network will be able to determine the accuracy of a capacity assessment. Anglo American believes that Aurizon Network should be required to provide detailed information on the baseline capacity of the CQCN, as well as the capacity that is currently available to users, so that users can determine whether a short term capacity transfer is viable, or whether Aurizon Network's capacity assessment is accurate.

Further, Anglo American believes that the capacity assessment criteria referred to by Aurizon Network in its discussion paper should also be made available on the Aurizon Network website.² Rather than simply providing information on what the capacity assessment criteria are, Anglo American believes that Aurizon Network should publish an exhaustive list noting what factors it will take into account when determining whether there is capacity available through a capacity assessment.

Anglo American notes that Aurizon Network appears to be concerned about the time that it will take to determine whether there is capacity available in order to grant minor alterations with a transfer (ie, scenario 2 where additional access rights are required).³ Aurizon Network has also suggested that where additional access rights are granted as part of a Short Term Transfer, Aurizon Network will require that "the available capacity for this type of transfer will be pre-determined."⁴ Anglo American does not believe that these requirements would be necessary with effective dynamic capacity modelling: rather, it should be a relatively simple process for Aurizon Network to quickly determine whether there is capacity available to be utilised. As such, Anglo American does not believe that requesting additional access rights should be as significant a concern for Aurizon Network as it appears in the Discussion Paper.

5. Transfer fees for Short Term Transfers

Anglo American notes that Aurizon Network has addressed the issue of socialisation of transfer fees by reference to the drafting in the 2014 SAAs. Anglo American reiterates this point that, while the SAAs have been proposed by Aurizon Network, there has been no

² Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 7.

³ Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 7.

⁴ Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 7.

agreement with industry or a final decision from the QCA in relation to the SAAs and so concepts should not be borrowed from or supported by the Aurizon Network unilateral drafting in the 2014 SAAs.

Anglo American does agree, however, that no transfer fee should be payable by the transferee or the transferor. In fact, Aurizon Network stands to benefit from the additional revenue it will collect from services being run that would otherwise not have. In most instances, Anglo American does not believe that a Short Term Transfer will result in any additional costs. Many of the administrative costs that Aurizon Network will be subjected to in order to facilitate a Short Term Transfer will already be covered by the corporate overhead allowance as staff costs and, Anglo American assumes, the costs already paid to Aurizon Network by customers for the purpose of ensuring that Aurizon Network has clear and dynamic capacity models in place.

Where Aurizon Network does have clearly evidenced reasonable and efficient costs that it has prudently incurred over and above the operating costs that it already receives from customers, Anglo American agrees that Aurizon Network should be entitled to recover these costs (if approved by the QCA). Anglo American does not agree with Aurizon Network's suggestion that the decision of how to recover these prudent costs should be left to a later date,⁵ as this only defers an important aspect of how the Short Term Transfer process will operate. Anglo American submits that the best method for Aurizon Network to recover any such prudently incurred costs is via a direct pass through to the transferee or transferor (as may be agreed) when the Short Term Transfer is completed.

6. Aurizon Network's right to issue a Short Term Transfer Refusal Notice

Anglo American notes that Aurizon Network has proposed some negatively drafted criteria in the suggested drafting for UT4.2 (ie, criteria for when Aurizon Network can issue a Short Term Transfer Refusal Notice).⁶ Anglo American agrees with some of the criteria, however, in addition to suggesting a requirement to give reasons for refusing a transfer, it makes the following suggested amendments:

- (a) **clause 7.5.3(b)(ii):** Anglo American has suggested that there should also be Short Term Transfer Destinations, so that existing Train Paths which are almost identical except for the Terminal or utilise capacity through neighbouring ports can also make use of the Short Term Transfer provisions. As such, Anglo American believes that this clause should be redrafted to read:

⁵ Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 13.

⁶ Anglo American understands that these are the criteria that Aurizon Network has proposed as clause 7.5.3(b) in the draft provisions in Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 23.

- (i) *"the destination for the proposed Short Term Access Rights is not a Substitutable Destination";*
- (b) **clause 7.5.3(b)(iii)**: Anglo American does not believe that this is an appropriate consideration for Aurizon Network to make a determination in relation to, as load out capacity is better assessed by the relevant Train or Mine Operator. Anglo American believes that this criterion should be removed as it is not appropriate for Aurizon Network to refuse to allow a Short Term Transfer because of a criterion that it is not best placed to make a determination on;
- (c) **clause 7.5.3(b)(v)** and **clause 7.5.3(c)**: Anglo American does not agree that Aurizon Network should be entitled to refuse to allow a Short Term Transfer where it is not satisfied that the transferee has a genuine intention or ability to utilise the Short Term Access Rights. Anglo American believes that this leaves Aurizon Network a subjective decision making power, rather than ensuring that the terms for refusal are clear and free from any real or impugned bias. Anglo American notes that Aurizon Network has attempted to maintain some objectivity by including clause 7.5.3(c), however, Anglo American does not believe that these are appropriate considerations, specifically because:
 - (i) **clause 7.5.3(c)(i)**: even where a transferee has not previously managed to utilise over 85% of its Short Term Access Rights (for any reason whatsoever), this does not provide any evidence for whether the transferee intends to fully utilise the Short Term Access Rights being sought this time. Lack of utilisation could be due to a number of factors, many of which are out of the control of the transferee and Anglo American does not believe that a proposed transferee should be punished for that. Importantly, Anglo American notes that Aurizon Network does not suffer any harm from underutilisation as it will still receive Take-Or-Pay for the Short Term Access Rights. Further, Anglo American does not believe that there is a high likelihood of another Access Holder being disadvantaged as the provisions clearly state that a Short Term Transfer is impermissible where another Access Holder's Access Rights would be impacted. As such, Anglo American does not see what this provision is protecting; and
 - (ii) **clause 7.5.3(c)(ii)**: Anglo American disagrees with the requirement that a transferee must have been fully utilising its Access Rights for the three month period prior to the Short Term Transfer. Anglo American believes that this requirement simply does not fit with the nature of coal mining and exporting,

especially when miners have export capacity through cargo assembly ports. Under the SAAs it is impossible for an Access Holder to utilise greater than 100% of its Access Rights (except with ad hoc capacity or a transfer), and the possibility that all aspects of the supply chain will operate smoothly for a full three month period so that a producer will achieve 100% of its allowable Access Rights is extremely slim. In fact, day of operations losses and other system losses mean a user is only likely to be able to use 85% of its contracted monthly entitlement hence the need for a reliable and effective transfer process to overcome this. Anglo American believes that this requirement is only marginally possible if the producer has access to a dedicated stockpiling port and that the requirement contained in clause 7.5.3(c)(ii) will only operate to undermine the Short Term Transfer process.

As such, Anglo American submits that Aurizon Network's proposed clauses 7.5.3(b)(v) and 7.5.3(c) are inappropriate and should be removed; and

- (d) **clause 7.5.3(b)(vi)**: Anglo American does not believe that another clause noting the protection of Aurizon Network's interests in Commercial Terms is necessary. This particular protection is already provided for in clause 7.5.1(d) of Aurizon Network's proposed drafting and Anglo American does not believe that it is necessary to repeat the protection of Aurizon Network's existing Commercial Terms.

While Anglo American understands that some of these restrictions have been included as "anti-gaming provisions" in order to prevent users from applying for transfers for reasons other than a requirement for capacity,⁷ Anglo American does not agree that these restrictions achieve this goal. A user's past history in relation to its current needs for capacity can be impacted by anything from its mining plan to its available capacity through other major infrastructure. If such anti-gaming provisions are built in to the short term transfer provisions they are likely to favour those producers with even railings capabilities that can ensure consistent output from their mines and ports, impacting on the commercially competitive mining industry.

7. Aurizon Network's liability to transferees

Anglo American notes that Aurizon Network has had some concerns about incorporating the Short Term Capacity Transfer provisions into the Access Undertaking and has commented that because it "is without the benefit of the usual contractual limitations on liability that

⁷ Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 9.

apply under the SAAs" it has "included a provision in the access undertaking to address the shortfall in protection which it would otherwise have the benefit of."⁸ Anglo American does not agree that this is necessary.

The Short Term Transfer Provisions already include protections to ensure that a transfer will not take place where either Aurizon Network or another Access Holder or Train Operator will be impacted. Further, Aurizon Network's Take-Or-Pay and revenue cap protections (which mean that Aurizon Network bears minimal risk on almost all aspects of the CQCN) still operate so that if transferred capacity is not utilised it has no impact on Aurizon Network's financial status. These provisions protect Aurizon Network from any additional risk that it might bear in effecting a Short Term Transfer and Anglo American does not believe that additional provisions should be included as Aurizon Network has more than adequate reductions to its liability. The purpose of regulation is not to protect the regulated entity from all risk, but to mimic a competitive market to the extent possible. Therefore, it is not appropriate that Aurizon Network is protected from all liability. In the view of Anglo American such unrestricted limitations on liability are not appropriate in the SAAs and are certainly not appropriate in the Access Undertaking.

Aurizon Network has also proposed a clause protecting itself from liability in any instance where it has made a good faith and reasonable attempt to comply with the provisions of clause 7.5 of the Access Undertaking.⁹ Anglo American notes that this is further protection for Aurizon Network in its role to facilitate the Short Term Transfer process. Anglo American believes that this is appropriate but should include a requirement for Aurizon Network to count the value of the subsequently unutilised train path toward the Maximum Allowable Revenue in any instance where Aurizon Network does not meet the good faith and reasonable test to comply with the Short Term Transfer Provisions.

8. Cap on transfer of capacity

Anglo American notes that Aurizon Network has proposed a cap on Short Term Transfers to a limit of 25% of the transferor's TSEs for a relevant origin to destination for that financial year. Anglo American does not agree with this cap.

Anglo American understands that part of the theory behind Short Term Transfers is to ensure that otherwise unutilised capacity is used, improving overall system throughput and efficiency (which Anglo American understands can only be for the benefit of the economy and the Queensland coal market). In light of that, Anglo American does not understand why, where a

⁸ Aurizon Network, *Discussion Paper on potential short term transfer mechanism* (December 2014) 11.

⁹ Anglo American notes that Aurizon Network's proposed drafting states the "relevant" provisions of clause 7.5, however, Anglo American does not understand which provisions are relevant to be complied with and which are not so submits that this "relevance" consideration should be removed.

producer feels that it has greater than 25% of its TSEs for a particular location to be traded, it would be practical to cap that transfer and for the capacity not to be utilised if there is a bone fide transferee wishing to use the capacity.

Further, Anglo American notes that Aurizon Network intends for this Short Term Transfer system to apply for users transferring capacity to themselves at other locations. In that instance, Anglo American sees that it would be irrational not to allow a user to transfer as much capacity as it requires (where that capacity is able to be traded according to the Short Term Transfer Provisions) between its two locations.

As such, Anglo American does not believe that the cap on the capacity that a transferor is entitled to transfer should be limited to 25%.

9. Interface with Train Operations Agreement

Anglo American does not believe that the current proposal submitted by Aurizon Network is clear regarding how the short term transfer provisions will interface with existing Train Operations Agreements (**TOA**). In particular, Anglo American is uncertain how these provisions will work between the Transferor's Train Operator and the Transferee's Train Operator once the capacity has been transferred. For example, Anglo American does not believe that the proposal is clear for instances where:

- (a) the Transferee is unable to obtain further rollingstock availability through its existing Train Operator and wishes to use the Transferor's existing Train Operator and the rollingstock capacity which will assumedly be available to match the transferred below rail capacity; or
- (b) the Transferee has received unacceptable terms from the Transferor's existing Train Operator (or already receives more preferable terms from its own Train Operator) and wishes to use its own existing (or ad hoc) above rail capacity to service the rollingstock required for the transferred capacity.

Anglo American believes that there should be clearer provisions in place as to whether the transferee is entitled to choose between TOAs and also whether it is required to complete a completely new TOA with a Train Operator in order to utilise the transferred capacity.

10. Timing, scheduling and day of operations

Anglo American believes that Aurizon Network should have to provide a timely response to any transfer request and if rejecting a request, reasons for doing so, with the relevant parties able to pursue dispute resolution if necessary, at least for transfer requests with sufficient notice and any ongoing refusals where time permits.

Anglo American has made extensive submissions to the QCA regarding the timing and structure of the DTP, ITP and MTP. Anglo American notes that Aurizon Network has included some extensive consideration of how timing, scheduling and day of operations management should work for the purposes of Short Term Transfers.

Anglo American does not believe that these decisions regarding timing can properly be made until the QCA has made a final determination regarding the timing and structure of train path scheduling and day of operations planning. For example, page 15 of the Discussion Paper refers to the fact train services once scheduled in an ITP cannot themselves be the subject of a short term transfer. Anglo American remains of the view that there should be no scheduling lockdown of any services until the 72/48 hour scheduling period, with any services outside of that period able to be altered or transferred.